TAXATION ON LIFE INSURANCE INCOME

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

EIGHTY-FIFTH CONGRESS

SECOND SESSION

ON

H. R. 10021

AN ACT TO PROVIDE THAT THE 1955 FORMULA FOR TAXING INCOME OF LIFE INSURANCE COMPANIES SHALL ALSO APPLY TO TAXABLE YEARS BEGINNING IN 1957

MARCH 5 AND 6, 1958

Printed for the use of the Committee on Finance

UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1958

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TAXATION ON LIFE INSURANCE INCOME

WEDNESDAY, MARCH 5, 1958

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 (chairman), Frear, Long, Anderson, Gore, Martin, Williams, Flanders, Carlson, Bennett, and Jenner.

Also present: Elizabeth B. Springer, chief clerk and Mr. Colin F. Stam, chief of staff of the Joint Committee on Internal Revenue taxation.

The CHAIRMAN. The committee will come to order.

The hearing is on bill H. R. 10021.

(H. R. 10021 is as follows:)

[H. R. 10021, 85th Cong., 2d sess.]

AN ACT To provide that the 1955 formula for taxing income of life insurance companies shall also apply to taxable years beginning in 1957

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. EXTENSION OF 1955 FORMULA TO 1957.

Subsections (a) and (c) of section 802 of the Internal Revenue Code of 1954 (relating to tax on income of life-insurance companies) are each amended by striking out "beginning in 1955 or in 1956" and inserting in lieu thereof "beginning after December 31, 1954, and before January 1, 1958,".

SEC. 2. TECHNICAL AMENDMENTS.

(a) The heading of section 802 of the Internal Revenue Code of 1954 is amended to read as follows:

"SEC. 802. TAX IMPOSED."

(b) The table of sections for subpart A of part I of subchapter L of the Internal Revenue Code of 1954 is amended by striking out

"Sec. 802. Tax imposed for 1955 and 1956."

and inserting in lieu thereof

"Sec. 802. Tax imposed."

(c) Section 811 (a) of the Internal Revenue Code of 1954 (relating to tax under 1942 formula) is amended by striking out "December 31, 1956" and inserting in lieu thereof "December 31, 1957".

Passed the House of Representatives January 30, 1958.

Attest:

RALPH R. ROBERTS, *Clerk.*

The CHAIRMAN. The first witness is the Honorable Dan Throop Smith, Deputy to the Secretary of the Treasury.

Will you come forward, sir, and take your seat.

STATEMENT OF HON. DAN THROOP SMITH, DEPUTY TO THE SECRETARY OF THE TREASURY, ACCOMPANIED BY DAVID LINDSAY, ASSISTANT TO THE SECRETARY

Mr. SMITH. Mr. Chairman, I find myself literally without a voice this morning. May I ask that my associate, Mr. David Lindsay, the Assistant to the Secretary, be permitted to read the statement that I have prepared on behalf of the Treasury.

The CHAIRMAN. I think this is the first time you have ever lost your voice before this Committee. We shall accommodate you.

You may proceed, sir.

Mr. LINDSAY. Mr. Chairman, I am glad to appear at the invitation of the committee in connection with the hearings on H. R. 10021. The Secretary of the Treasury in identical letters of January 10, 1958, to you and to the Honorable Wilbur D. Mills, chairman of the House Ways and Means Committee, said:

> Pursuant to various conversations which we in the Treasury have had with you and other members of your committee, I am writing with reference to the income-tax law which will apply to the 1957 earnings of life-insurance companies, concering which the members of your committee and the Treasury have been and are receiving a large number of inquiries.
>
> As you know, in the absence of new legislation, life-insurance companies will be taxed for the year 1957 in accordance with the 1942 formula which has not been applied since 1948. I believe it to be generally agreed that the application of the 1942 formula would, after a lapse of 8 years, produce some inequitable results.
>
> For the taxable years 1949 through 1956 a succession of interim laws were adopted, of which the most recent was the law effective for the taxable years 1955 and 1956.
>
> The Treasury Department believes that it is most desirable that a permanent method of taxation of life-insurance companies be worked out, and we hope to propose in the very near future an approach which we believe will be reasonable and equitable for the foreseeable future.
>
> I am sure that the House Ways and Means and the Senate Finance Committee will want to consider any such proposals in the light of testimony that will be submitted and other considerations which the members of your committee may want to suggest or evaluate.
>
> Under these circumstances, and because of the complexity of the subject, it is not probable that final legislation, along whatever lines the Congress determines is appropriate for permanent legislation, could be adopted before March 15 when the returns for the 1957 taxable year are due.
>
> An important fact is we are dealing with institutions with responsibility for the insurance policies of millions of American people and final decisions by the life-insurance companies as to policy dividends and surpluses for the year 1957 will depend to some extent on the final determination of their tax liability. In view of this, and in order to assure full consideration of the best permanent method of taxation of insurance-company income, it would seem reasonable to extend the law effective for the taxable years 1955 and 1956 for another year and make it applicable for 1957 income. It would be my hope that we could then proceed to work out a permanent method of taxation in this area which would be fair and equitable.
>
> Accordingly, the Treasury would go along with an extension of the 1955 legislation so that it might be applied to 1957 income of life-insurance companies.

H. R. 10021 provides for a 1-year extension of the most recent stopgap method of taxing life-insurance companies. The Treasury's position on it is indicated in the letter of the Secretary which I have just read.

In response to questions asked by members of the committee, I have prepared certain supplemental statistical information on the varying impact of an application of the 1942 method of taxation on differ-

ent companies. I shall be glad to make that material available in any way which is desired, either by reading it, by inserting it in the record, or by turning it over to the staff of the committee.

Thank you.

The CHAIRMAN. Now, Mr. Smith, the Chair wants to ask you a question, and a definite answer is requested. When, on what day, can you guarantee that your report will be made to the Congress with respect to the permanent method of taxation of insurance companies?

Mr. SMITH. I am willing to assure you, Mr. Chairman, that I see no reason why it can't be done within 30 days.

The CHAIRMAN. Leave out the qualifications. We want a day. This is March 5. Now, by April 5 will that report be sent to Congress?

Mr. SMITH. April 5 is Saturday. I would suppose that April 7, the following Monday—I am not bargaining for an extra 2 days, Mr. Chairman, I just happen to recall the date.

The CHAIRMAN. Will you guarantee or assure this committee that the report will be made not later than April 7?

Mr. SMITH. We will submit something to the Ways and Means Committee, to the Congress, by that time.

The CHAIRMAN. When you say "something," do you mean your recommendations on the permanent method of the taxation of the insurance companies?

Mr. SMITH. Our recommendations, yes.

The CHAIRMAN. We can accept that as a fact? Because, as you know, this report has been delayed a long time, and this committee I know, would like to have a positive assurance that on a certain day it would be available. The date is April 7?

Mr. SMITH. I will give you such assurance, Mr. Chairman.

Senator FLANDERS. Mr. Chairman, I might call attention to a piece of information which I received this morning to the effect that we will be in recess from Thursday evening the 3d to Monday morning the 14th. Now, that gives the Treasury a little bit more time than they are entitled to. What are we going to do about it?

The CHAIRMAN. While the Senate may be in recess, the committee can still consider legislation, and we can give it our full attention during the recess.

Senator FLANDERS. All right. Monday, April 7.

The CHAIRMAN. What is the pleasure of the committee as to the statement Mr. Smith referred to? Should it be read and inserted in the record or turned over to the staff?

Senator ANDERSON. What is the nature of it? I think I asked him to show cause why this was necessary with respect to these insurance companies. Does he show that they are in such dire circumstances as to need a $124 million rebate? Is that what he has supplied?

Mr. SMITH. It is not in terms of the explanation of the cause as to why relief is necessary. It is, as my statement indicated, statistical information as to the varying impact of the 1942 legislation on different companies and categories of companies. It is statistical information and an explanation of the reasons for the difference.

Senator ANDERSON. The statement says:

I believe it to be generally agreed that the application of the 1942 formula would, after a lapse of 8 years, produce some inequitable results.

Is that what the material shows, inequitable results?

Mr. SMITH. It shows varying results on varying categories of companies.

Senator ANDERSON. Varying, but inequitable?

Mr. SMITH. I think everyone should draw his own inference as to what is inequitable or not.

Senator ANDERSON. The thing is, the Secretary wrote a letter in which he uses this phrase—I am quoting from your own statement:

I believe it to be generally agreed that the application of the 1942 formula would, after a lapse of 8 years, produce some inequitable results.

Senator MARTIN. Why not read it now, and then it will be a part of the record? Would it be agreeable to make it part of the record and turn it over to the staff for study, and then all of us can read it in the record, and we will all have a copy of it to read in the meantime. That will save us some time.

Senator WILLIAMS. Except that there may be some questions.

The CHAIRMAN. It is not a long statement.

Mr. LINDSAY. It is headed "Supplemental Statistical Material on Varying Impact of the 1942 Formula for the Taxation of Life Insurance Companies."

The material reads as follows:

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

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

Table 1 below presents a summary comparison of the actual net rates of tax on the investment income, applicable to different brackets of income, under the stopgap method and the 1952 formula.

Table 1 shows the net investment income in the first column, bracket rates of tax in the second, third, and fourth columns. The second column shows the stopgap method, the third column the 1942 formula, and the fourth column the difference between the stopgap method and the 1942 formula. The fifth column shows the percentage increase in tax, the 1942 formula over the stopgap.

Would you like me to read the figures on the table, Mr. Chairman?

The CHAIRMAN. I think everyone has a copy of the table. Without objection, that will be inserted in the record.

(The table referred to is as follows:)

TABLE 1.—*Comparison of bracket rates of tax under stopgap method and 1942 formula*

[In percent]

Net investment income	Bracket rates of tax [1]			Percentage increase in tax: 1942 formula over stopgap (4)÷(2)
	Stopgap method	1942 formula	Difference, (3)−(2)	
(1)	(2)	(3)	(4)	(5)
0 to $111,907	3.75	6.7	2.95	78.7
$111,907 to $200,000	3.75	11.62	7.87	209.8
$200,000 to $1,000,000	6.5	11.62	5.12	78.7
Over $1,000,000	7.8	11.62	3.82	48.9

[1] Bracket rates apply to indicated segments of income.

NOTE.—Figures in this table do not reflect the operation of the special interest deduction for companies whose earnings are less than 105 percent of their required interest, which might further reduce taxable income by as much as one-half.

Mr. LINDSAY. I might just indicate in the second row of the figures, for net investment income of between $111,907 and $200,000, the percentage increase is 209.8 percent. The 136 percent increase indicated in the statement before is a combination, a weighted average between the first row of 78.7 percent increase and the second row of 209.8 percent increase, for income ranging from zero up to $200,000.

Senator ANDERSON. Could you give us the percentage of the life-insurance business in the country that is done by an investment company of $111,907 to $200,000? I don't know where you got that figure.

Mr. LINDSAY. That figure was computed as a breaking point for showing the percentage increase at that point.

Senator ANDERSON. Where did you get the $111,907?

Mr. LINDSAY. That is the way the formula breaks. You would find perhaps a company with income ranging up to $200,000, so that the increase on their first $111,000 of net investment income would be 78 percent, and the increase on the balance would be 209 percent, but the overall increase on $200,000 under the circumstances would only be 136 percent.

Senator ANDERSON. Well, how many companies, and what percentage of the insurance business is done by companies with net investment income under $200,000?

Mr. LINDSAY. We don't have the figures on that; we will try to get them.

Senator ANDERSON. We want to try to see how this is inequitable. Whom is it inequitable upon?

Mr. SMITH. I would say this, Senator Anderson—and this is in answer to your earlier question as to whether this is inequitable—it seems to us that such a very large proportion in the increase of the tax on the small companies is inequitable. This table indicates the varying impact of the 1942 formula upon companies depending upon their size of net investment income.

I do not have here the specific companies or the number of companies; we shall be glad to attempt to get the number of companies for the record. Of course, the identification of the companies would be based upon tax returns, which would not be available for insertion in a public record.

(The information requested is as follows:)

Out of a total of 1,249 Federal income-tax returns of life-insurance companies for 1956, filed through August 7, 1957, 901 showed net investment income under $200,000. In addition, 70 returns showed no net investment income.

Senator ANDERSON. They don't make that available to the State insurance commissions?

Mr. LINDSAY. The taxable income is somewhat different than the reported income. This is based upon their income as reported for tax purposes, Senator.

Senator ANDERSON. And they don't report in their statements the amount of Federal taxes that are due?

Mr. LINDSAY. I think they report the amount of Federal tax, but they do not report, to the best of my knowledge, their net taxable income as computed under the Federal tax laws.

Senator ANDERSON. They don't report their investment income, for example?

Mr. LINDSAY. Under the definition, as applied under the Federal tax laws, that is the same for life-insurance companies as for corporations in general, the various allowances and required inclusions under the concept of the tax law frequently is a somewhat different net taxable income from the income as reported for public purposes. That applies to corporations in general, including life-insurance companies, also for individuals, of course.

Senator WILLIAMS. Mr. Smith, you referred to this formula as representing increasing in the existing insurance-tax liabilities. Would it not be more proper to refer to the fact that the adoption of this bill would represent those corresponding decreases in their tax liability as compared with existing law?

Mr. SMITH. The table is not intended to prejudge one way or the other. If it is not clear, this is the difference that should be labeled as the difference between the stopgap formula and the 1942 law.

Senator WILLIAMS. What is the existing law during the calendar year 1957?

Mr. SMITH. The existing law is the 1942 formula.

Senator WILLIAMS. And the stopgap law, so to speak, is a retroactive tax deduction rather than what we are speaking of as increases; in that not true?

Mr. SMITH. As I read the heading on the table, I note it says "Comparison of bracket rates of tax under stopgap method and 1942 formula," and the 2 are listed in dispassionate, objective headings, and 1 is simply an increase of the 1942 formula over the stopgap formula. There is no attempt to prejudge either way.

Senator WILLIAMS. I just wanted to get that clear, because I notice in the opening of your statement, the last one, you say:

A reapplication of the 1942 formula would increase the overall tax liabilities of life-insurance companies by an estimated $125 million, or about 43 percent above the stopgap method.

Now, we are not dealing with the problem here which will increase the liability, we are discussing a measure which will decrease their liability; is that not correct?

Mr. SMITH. That is correct, Senator.

Senator ANDERSON. Isn't that the point all the way through, the application of the 1942 law is the law; is that not correct?

Mr. SMITH. That is correct.

Senator ANDERSON. And the proposals that are being offered are remedial legislation. Why not show the percentages of tax reductions offered to various income-tax groups? You have got it down here as increases. These aren't increases; these are decreases you are talking about. Nobody has proposed an increase except that Senator Kerr proposed to go from the 1942 law to 1950. We may want to study that, but this proposal is a decrease in tax, a retroactive decrease in liability, is that correct?

Is there anything else before this committee except a retroactive reduction in taxes for 1957?

Mr. SMITH. To the best of my knowledge, that is what is before the committee. There are varying definitions as to the significance of "retroactive."

Senator ANDERSON. Well, if the tax was due on the 1st day of January 1958, and has not been paid, it is due; isn't it?

Mr. SMITH. It is due on March 15.

Senator ANDERSON. It is due to be paid into the Treasury?

Mr. SMITH. Yes.

Senator ANDERSON. The computations have already been made in 1957, every insurance company has filed a tax statement in the District of Columbia, filed it on the 15th of March, and that is accurately reflected, I am sure, as a tax liability; isn't it?

Mr. SMITH. I am not aware of what other statements they filed, Senator.

Senator ANDERSON. You mean the Treasury never looks at anything of this nature?

Mr. SMITH. I am familiar with those reports, but I do not know when they are due and in what particular jurisdictions.

Senator ANDERSON. If I said they were due on the 28th of February here, would you have any reason to doubt the statement?

Mr. SMITH. I most certainly would not doubt it.

Senator WILLIAMS. Mr. Smith, I think the other day we were discussing the possibility of adopting, in connection with this stopgap formula, a suggestion of carrying the same exemption for the smaller companies and still let the 1942 act go into effect otherwise.

What would be the difference in the revenue if that had been adopted? I forget who made the suggestion, but I think it was mentioned at that time. In other words, if you are speaking of the impact it would have on small companies, and the question was raised, if we eliminated those companies, or gave an exemption to all companies which would have the effect of eliminating them.

Mr. SMITH. It is in the order of about $10 million, Senator Williams.

Senator WILLIAMS. It would be about $10 million out of the $124 million, if we eliminated the small companies now?

Mr. SMITH. Yes.

Senator WILLIAMS. Now, that is up to what size?

Mr. SMITH. That would be based upon a higher allowed rate of deduction on the first $1 million of investment income, which is what existed under the 1955 stopgap law.

Senator WILLIAMS. And that would leave those with the first $1 million pretty much under the existing law, and the rest on the 1942

formula? You are not figuring on a complete exemption, below the $1 million, but that is just existing law?

Mr. SMITH. The first $1 million.

Senator WILLIAMS. But in arriving at that, how would you be dealing with the first $1 million?

Mr. SMITH. That can be done by continuing the present 87½ percent credit instead of going to the 77 and a fraction percent.

Senator WILLIAMS. That is what I want to get.

Senator ANDERSON. Do you think that would be bad? It is these small companies, the ones you are worried about. It would give them some relief.

Mr. SMITH. Yes.

Senator ANDERSON. Very substantially.

Senator WILLIAMS. That would take care of them as well as they have been taken care of in prior years; would it not?

Mr. SMITH. That would be substantially the same treatment for the small companies.

Senator ANDERSON. And that would reduce the $124 million to $114 million?

Mr. SMITH. Yes.

Senator CARLSON. I think it would be very helpful if we could get, at least in executive session, the number of companies in these four categories.

Senator Anderson is getting into that. I think it would be helpful if we could get that.

Senator ANDERSON. I think it is the only thing you have to have. You want to show who needs it and how they need it, otherwise it is just a $124 million gift.

Mr. SMITH. Shall we continue with the analysis of the reports?

Mr. LINDSAY (reading):

In addition to the special situation of small companies, another factor accounting for shifts in relative burden under the 1942 formula would be the resulting change in the taxation of health and accident business. The stopgap method taxes the health and accident business of life-insurance companies as though it were in the hands of a mutual casualty insurance company. It determines the income subject to regular corporate rates on the basis of the ratio of nonlife reserve to total insurance reserves. It also taxes a proportionate part of capital gains allocable to health and accident business at regular capital gains rates. The 1942 formula views nonlife insurance income as a flat 3¼ percent of unearned premiums and unpaid losses in the health and accident department and disregards capital gains. The arbitrary 3¼ percent is generally less than the allocable health and accident business earnings under the stopgap method. For this reason as well as the nonrecognition of capital gains, the 1942 formula would tend to reduce the relative share of the tax borne by companies doing substantial amounts of health and accident business.

Table 2 shows the comparison of tax liabilities on health and accident insurance business under the stopgap method and the 1942 formula, 10 large companies, based on 1956 conditions. The figures are shown in thousands of dollars.

(Table 2 referred to is as follows:)

TABLE 2.—*Comparison of tax liabilities on health and accident insurance business under the stopgap method and the 1942 formula: 10 large companies, based on 1956 conditions*

[Thousands of dollars]

Company	Stopgap	1942 formula	Decrease	Company	Stopgap	1942 formula	Decrease
1	$2,547	$2,181	$366	7	$24	$20	$4
2	905	806	99	8	55	52	3
3	1,158	1,031	127	9	7	5	2
4	287	271	16	10	176	139	37
5	561	450	111				
6	1,725	1,571	154	Total	7,445	6,526	919

Senator ANDERSON. Do you have some studies which show that if they would pay more tax on life insurance they would pay less tax on health and accident, and therefore come out about the same? If that is so, who is financially damaged, and how?

Mr. LINDSAY. Overall, in most instances, they would not come out the same. But it is true that the more accident——

Senator ANDERSON. Well, if some come out the same, if we had some figures, we would be able to eliminate those in this legislation, wouldn't we? Do you have any figures showing who they are?

Mr. LINDSAY. That could be worked out based on the same sample companies that were picked for the purpose of table 2, which shows only the accident and health insurance segment of the returns.

Senator ANDERSON. On that first table, on that table 2, you are very much concerned about the small companies. Here we have the 10 large companies. Is there any reason why we shift from small to large companies on accident and health?

Mr. LINDSAY. No, except that I imagine that as a matter of getting these figures together it was comparatively simple to get some selected companies' returns that we would know had a substantial amount, a reasonable amount of accident and health insurance business, so that we could see how in different situations the 1942 formula and stopgap formula would affect the tax liability, and whether there was an even-handed percentage difference dependent upon the amount of business done. This table indicates that there is no logical pattern to the amount of the decrease.

Mr. SMITH. It is our feeling, Senator Anderson, that the stopgap formula is a reasonable method of taxing the health and life aspect of the business.

Senator ANDERSON. The health and accident?

Mr. SMITH. The health and accident aspect of the business.

Now, we could provide in executive session, if so requested, specific examples of the extreme instance referred to at the beginning, that would of course be based upon an individual company's return which could not, under the law, be identified in a public record.

Senator ANDERSON. You could also leave out health and accident, couldn't you? Senator Williams spoke about small companies.

Mr. SMITH. In that case there would be—and I believe this was suggested earlier on the basis of some informal discussions I have had—the thought that the 1955 stopgap formula might be adopted by varying the percentages allowed under it, instead of the 85 percent allowed for the larger companies. Some other formula, some other figure

might be adopted which would get a different amount of revenue, thereby maintaining the differential treatment that Senator Williams referred to for the smaller companies, together with the improved method of taxing the health and accident business in the way that I believe your question at least implies.

Senator ANDERSON. Are the large writers of health and accident the life insurance companies, say the two largest writers, Mutual of Omaha may be one of them, and another company in Chicago?

Mr. SMITH. I am sorry, I am not sufficiently expert in the field to know, Senator.

Senator ANDERSON. I was reading in one of the business magazines a while ago about the two largest health and accident writers, and one company in Chicago was listed, and Mutual of Omaha was the other. Are they life companies?

Mr. SMITH. I understand there is a substantial amount done, but a varying proportion of the total business of the individual companies going into this particular aspect of the insurance.

Senator WILLIAMS. In this table No. 2 you have 10 companies listed by number.

Mr. SMITH. Yes.

Senator WILLIAMS. Did those same 10 companies also have some life insurance?

Mr. SMITH. Yes, these are all life-insurance companies, this is carving out the small but varying fraction of their total business relating to health and accident insurance.

Senator WILLIAMS. But the net result of any one of those 10 companies, would they then endorse the continuation of the 1942 formula, in view of the fact that they get some reduction in one phase of it?

Mr. SMITH. I don't know, I don't have these particular 10 companies set up in the aggregate, on what is the combination of the effect of the health and accident change and the other change.

Senator WILLIAMS. Could you extend out the same information on the same 10 companies in a couple of more columns and show the increases that would likewise be under there, and the total change?

Mr. SMITH. Yes, I think we could do that.

(Committee clerk advised by Treasury representative that information could not be compiled in time for inclusion in printed record.)

Senator WILLIAMS. I think then we could have a clear picture.

Senator ANDERSON. Wouldn't you have to do that in order to find out whether they are financially damaged by going back to the 1942 law? If they get helped on one hand and hurt on the other, don't you try to balance it out?

Mr. SMITH. What we attempt to do here, Senator Anderson, is to indicate the variety of the reasons for differences in the impact of the 1942 law as compared to the law that has been in effect for the recently preceding years.

Senator ANDERSON. I don't understand the meaning of this first figure of $2 million. I don't know whether that figure of $2 million means that company No. 1 is going to pay that in taxes, and then under another formula it is going to pay $2,181,000, with a saving of what, $366,000?

Mr. SMITH. It means precisely that insofar as their health and accident business is concerned.

Senator ANDERSON. You must know what happened to No. 1 company that you have listed here, what happened to their investment income.

Mr. SMITH. I don't have those figures now.

Senator ANDERSON. Wouldn't it be interesting to know?

Mr. SMITH. If the committee wants it, we will be glad to provide it.

(Committee clerk advised by Treasury representative that information could not be compiled in time for inclusion in printed record.)

Senator ANDERSON. If they get hurt one way and helped the other, don't you take that into consideration?

Mr. SMITH. Senator, as I said earlier, our attempt was first to determine and then indicate the reasons for what appeared to be highly varying results of the change in formula, in a sense almost a capricious change, because of the varying compositions of their business.

Seantor ANDERSON. You think that a change from $7.4 million to $7.5 million is a drastic change in the whole life-insurance structure of the company?

Mr. SMITH. No. But when I note that for some companies the proportionate change is in the ratio of 7 to 5, and in other companies it is in the ratio of 55 to 52, I note that the percentage impact varies considerably. And that is all we were attempting to determine here.

Senator ANDERSON. How much different is from 55 to 75 than from 176 to 139?

Mr. SMITH. The difference between about 29 and 21 percent. On the other hand, going one up to company No. 8, it is a difference of 5 percent. So you have a low of a 5½-percent decrease, and a high of 28.6-percent decrease, which proportionately is substantial.

Senator FLANDERS. Mr. Chairman, I would like to inquire of Mr. Smith the purpose of this table 2.

Am I right in assuming that it is simply intended to show that in one element of insurance being taxed, there is a considerable lack of logic in the incidence of the law of 1942? You are just talking about that area, and in that area the 1942 is the logical?

Mr. SMITH. That is precisely the point, Senator Flanders.

Senator ANDERSON. Now would you have the figures at all on Bankers Life and Casualty of Chicago and Mutual of Omaha, which I believe are the two largest writers of accident and health insurance? You are obviously trying to show that this branch of the life-insurance company is going to be in some complexity if not trouble. Now, let's find out how it varies from the companies who are principally writing accident and health. Do you have figures on those?

Mr. SMITH. Senator, we are barred by law from revealing any specific figures reported by individual companies in their tax returns in public hearings.

Senator FREAR. The stopgap legislation now in effect, the 1955–56 legislation known as the Mills proposal or stopgap legislation, how in comparison to the 1942 formula does it treat all companies, large and small, those that have health and accident and those that have purely life, inequitably?

Mr. SMITH. The 1942 formula allows a deductible credit for reserve interest based on a weighted average, 65 percent of which assumes a requirement of 3¼ percent as needed return on investments. The other 35 percent is based upon the average for the industry, the aver-

age amount required for the entire industry, based on the policies they have written.

Senator FREAR. You are giving him the figures, Mr. Smith, and I think that is very well for those that understand them; I am not sure that I do. But obviously in your recommendation of the extension of the 1955–56 formula in the present bill before us, H. R. 10021, to me it is obvious that the Treasury feels that that formula is more equitable to all the companies concerned than is the 1942 formula, is that a fair statement?

Mr. SMITH. May I first make the record clear, Senator Frear. This is not a Treasury recommendation. The statement in the letter of the Secretary which was read was:

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

Senator FREAR. Then we will have to wait 10 years for a recommendation from the Treasury. I think the insurance companies have a right to expect it long before, and I think they have a right to expect from us some action on this. I don't like retroactivity for or against the taxpayer. But we are in this predicament, and I think the Treasury Department does recognize that. And I think we are faced with a decision that is going to be made in a few days. I don't think we can make an equitable decision, personally I doubt it, but I think the one that is going to come closest to being an equitable decision is the one we arrive at, and which I am trying to determine, as to whether the 1955–56 formula is a more equitable one for all life-insurance companies concerned than is the 1942 formula.

Mr. SMITH. The stopgap formula, the 1955–56 formla, has, in our opinion, certain advantages with reference to the differential tax on small companies which has already been referred to, and with reference to the treatment of the health and accident aspect of the life-insurance business, because it is more closely related to the actual earnings thereon rather than a general presumption. As to the basic difference in terms of the total revenue, I have no position one way or the other indicating a preference for one over the other. I will merely repeat the Secretary's statement that the Treasury would go along with the extension of the 1955 legislation, and I assure you that it will be at least as much of a relief to us and the Treasury as it will to you gentlemen here to have something on a permanent basis adopted. We don't relish this any more than you.

Senator FREAR. That we can agree on.

Mr. SMITH. That we can agree with.

Senator ANDERSON. The Mills law was supposed to be permanent legislation, and the Treasury opposed it.

Mr. SMITH. The treasury opposed it as permanent legislation, that is correct, and the Treasury would oppose it today if it were proposed as permanent legislation.

Senator ANDERSON. And every time you extend it you are extending legislation that the Treasury opposes.

Senator FREAR. We are trying to arrive at a formula, at least one member of the committee is trying to arrive at a formula, something that is not going to be too drastic on any insurance company. Yet I believe the Secretary of the Treasury is not going to demand that we decrease taxes in this area where there is a feeling that they are a

bit undertaxed now, I mean usually the Treasury comes up here, and when there is recommendation for a reduction in taxes there is a bit of opposition to it. And I consider that as a fair standard formula for you to operate by, I am not critical of that. I recognize you are the protector of it. And I want to be with your position whenever I can. But the thing that I have to repeat is that if 1955–56 formula is more equitable to all insurance companies concerned than is the 1942 formula, why can't we take a percentage base on their tax in 1956 and add it by simple percentage? If their tax was not enough in 1955–56, say, all right, we will figure the return on those the same as we have, and at the end we are going to let the Treasury say, add 50 percent to this tax, or whatever that percentage may be, or in lieu of that, take the reduction on the first $1 million, if you want to segregate it for small companies, and reduce those figures by whatever is required to make a 50 percent increase in tax.

Mr. SMITH. That certainly could be done, Senator Frear.

Senator FLANDERS. Before I make the observation that I am about to, I would like for the record to state my personal connection with the insurance industry. I have been for many years a director of the National Life Insurance Co., of Montpelier, Vt. It is a mutual insurance company. When I left the business and came to the Senate I resigned from every directorship which I held—and there were a great number of them—except those that I felt had a public interest. I very strongly classify this mutual life insurance of which I was a director as holding a major public interest.

The directors of such a company are in effect fiduciary officers. They are trustees of other people's money. And it was that aspect of my directorship that led me to retain it.

Now, starting first with the mutual companies, it seems to me clear, as brought out by Senator Williams, that this is technically—I underline the word "technically"—a reduction in taxes since, without our action here between now and March 15, the taxes will be greater under the 1942 law, the total taxes, than are the taxes under the stopgap formula.

So technically, it is a reduction in taxes. That point of view I must accept and we all must accept, because it is a technical fact.

Now, when the term is used "tax relief"—and I say this in all kindness to my friend, the Senator from New Mexico—when you say "relief" you are talking about somebody or other or something or other which is being relieved. And still speaking for the moment from the standpoint of the mutual companies, with which I am connected, who is it that pays the taxes?

There is no company to tax. There is nothing to tax but individuals scattered all over this country who are policyholders. There is nothing else to tax, nobody else to tax; there is no company to tax.

Now, these policyholders, as a reaction or as a necessary effect of our decisions here on taxes, are subject to two types of effects. They can either have higher premiums charged for policies and/or lower dividends credited to their policies. In other words, the people who we are affecting in the mutual companies are people; they are millions of people all over this country. They are not disembodied companies.

So that when we say "tax relief" what we are really saying in the opposite sense is that we decided that individual people the country over shall pay higher premiums for insurance, or shall receive lower dividends.

Now, that is as far as the mutuals go. There is no company to be taxed. There are only individuals scattered all over the country to be taxed.

Now, when it comes to the stock companies, there is a company to be taxed. There are certain stockholders whose earnings are affected as the company is taxed. But here the situation, Mr. Chairman, seems to me to be on all four feet with the mutual company to this extent and for this reason, that the stock companies are in constant and severe and unremitting competition with the mutual companies, and they cannot get far out of line without going out of business.

And for that reason it seems to me we can depend upon it that the stock companies are in the same situation as the mutual companies.

And so, Mr. Chairman, this is the end of my little dissertation on tax reduction and tax relief.

The CHAIRMAN. Thank you very much for that contribution.

I would like to ask Mr. Smith this question. Congressman Mills on the floor of the House, January 30, said this:

> The Treasury Department has joined the committee in recommending extension of the stopgap formula of H. R. 10021 to the year 1957 in preference to letting the 1942 formula apply. We have hopes that a permanent solution will be found this year to apply to 1958 and subsequent years.

So, we all recognize the fact that the Treasury joined with the Ways and Means Committee in supporting the stopgap legislation under the conditions that exist.

I just want to ask one more question in regard to the 1942 legislation. That was not reliable legislation in the sense it fluctuated, the returns did, in accordance with interest rates, and, as a matter of fact, the taxes paid by the insurance companies were greatly reduced.

And, as a long-range, permanent solution, I imagine that was one of the reasons why you preferred the stopgap legislation until some other plan could be worked out other than the 1942 formula.

Mr. SMITH. That is correct, Senator.

The CHAIRMAN But, as I understand it, the taxes to be paid fluctuate in accordance with the weighted average basis in the 1942 act of 3¼-percent as compared to the actual earnings. That is not a satisfactory system. The proof is that in 2 years the taxes from the insurance companies were substantially reduced, and the interest rates were low.

In other words, in 1946 and 1947, the rates of return on investments were 2.93 in 1946 and 2.88 in 1947, but the deduction was fixed in the law at 3¼ percent; is that correct?

Mr. SMITH. Yes. Most of the deduction was made on the 3¼ percent.

The CHAIRMAN. In other words, by its operation the 1942 act has been shown to be not a dependable source of taxation. It fluctuates to a point where, in those years, at least, it was very injurious to the Government in the collection of taxes; isn't that right?

Mr. SMITH. That is correct.

The CHAIRMAN. Are there any further questions?

Senator BENNETT. I would just like to add one question to nail down the point that the chairman has been making. Senator Frear asked the witness, earlier, if the Treasury would support the stopgap as permanent legislation, and the answer was "No." Now, as a companion question, would the Treasury support the 1942 act as permanent legislation?

Mr. SMITH. Equally, no.

Senator BENNETT. Thank you.

Senator LONG. Why has it taken so long to get a Treasury recommendation up here, Mr. Smith?

Mr. SMITH. Simply because——

Senator LONG. We want something to vote for, some of us, and we have been waiting a long time to see it.

Mr. SMITH. Well, as I told Senator Frear earlier, we will be at least as glad as you gentlemen here when we can get permanent legislation. It has been an extremely complicated and difficult subject on which to appraise all of the special situations that exist in the country.

Senator LONG. Any time anyone finds the prospect of his taxes being increased, he can find a lot of objections to your proposal, can he not?

The CHAIRMAN. I would like to say to the Senator from Louisiana—he was not present earlier—that Mr. Smith has made an absolute commitment to present his recommendations on April 7.

Senator LONG. Good.

The CHAIRMAN. Have you completed your statement?

Mr. SMITH. We have one more set of figures that I think might be of interest, Mr. Chairman.

Mr. LINDSAY. To proceed:

Another important feature of the increase in tax under the 1942 formula is its varying impact on the available margin of investment income of different companies. Like other industrywide averaging formulas, including the stopgap, the 1942 law imposes tax in proportion to net investment income, based on a specified deduction ratio. This deduction ratio reflects industry average conditions, not the situation of the particular company.

The 1942 formula assumes that some 22.34 percent of each company's investment income is income over and above interest requirements. However, actual margins vary widely among companies.

Data from the 1956 tax returns of 16 very large companies are presented in table 3, below.

(Table 3 is as follows:)

TABLE 3.—*Policy interest requirements, 1956, 16 large companies*

Company	Percentage of investment income needed to meet policy interest requirements	Percentage of investment income after required interest	Company	Percentage of investment income needed to meet policy interest requirements	Percentage of investment income after required interest
A	0.5922	0.4078	J	0.6900	0.3100
B	.6287	.3713	K	.6972	.3028
C	.6353	.3647	L	.7031	.2969
D	.6624	.3376	M	.7077	.2923
E	.6639	.3361	N	.7246	.2754
F	.6672	.3328	O	.7319	.2681
G	.6774	.3226	P	.7734	.2266
H	.6862	.3138			
I	.6871	.3129	Average	.6922	.3078

NOTE.—Percentage of investment income required to meet policy interest requirements is computed in this table and in table 4 in accordance with the 1950 statutory formula.

Mr. LINDSAY. Table 3 shows the data from the 1956 tax returns from 16 very large companies. It shows the percentage of investment income needed to meet policy interest requirements in the middle column. The average for the group is a little over 69 percent. The percentage of investment income after required interest is shown in the last column. It will be seen that there is quite a variance among the individual companies lettered from A through P, varying from 77 percent to 59 percent on percentage of investment income needed to meet the policy requirements.

Senator ANDERSON. What are they all allowed?

Mr. LINDSAY. They are allowed different amounts under the different formulas.

Senator ANDERSON. Under the stopgap law, 85?

Mr. LINDSAY. 85 percent, except for the first million of that investment income, which would be 87½ percent.

Senator ANDERSON. So if the company needed 59.52, and it is allowed 87, it is doing first rate, isn't it?

Mr. LINDSAY. It is correct that the company needing 59 is being allowed 85 or 87½.

Senator ANDERSON. They would be doing pretty well on that basis, wouldn't they?

Mr. SMITH. They would. The impact, I would imagine, of the 1942 formula would be greater for P in one instance than it would be in the instance of the adoption of the 1942 formula, because it would just wipe out the percentage of the investment income that is free, that is, not required to meet policy interest requirements. So P would be affected to a greater degree than A would be affected by that change. And that, I think, is all that this table ——

Senator ANDERSON. That is true, but when you raise it only to 77 percent on the 1942 formula, actually none of these 16 is being damaged?

Mr. LINDSAY. That is correct.

Senator ANDERSON. And company A has 40 percent of its investment income that it doesn't require for the purposes that it is freed from taxation, is that right?

Mr. LINDSAY. That is correct.

As a group, these companies needed about 69 percent of their investment earnings to meet policy and other contractual interest requirements. This indicates about a 31 percent margin of investment income in 1956 as against the 22.34 percent margin now subject to tax under the 1942 formula. Owing to variations within the group, company A had a margin of about 41 percent or nearly twice the proportion assumed by the 1942 formula. At the other extreme, company P had a margin of about 22.7 percent, or barely as much as the proportion subject to tax in 1957 under the 1942 formula.

While there is some variation in the margins of investment income above required interest by size of company, as shown in table 4, the differences among the size groups shown are less than those typically occurring between companies within a size group.

(Table 4 is as follows:)

TABLE 4.—*Percentage of investment income needed to meet policy interest requirements, by size of company*

	Percentage of investment income needed to meet policy interest requirements	Percentage of investment income after required interest
1. All companies	0.7069	0.2931
2. 16 largest companies	.6922	.3078
3. Companies with above $1,000,000 net investment income, other than 16 largest	.7507	.2493
4. Companies with net investment income of $1,000,000 or less	.7149	.2851

Mr. LINDSAY. Table 4 breaks this information down—1 is for all companies, 2 is for the 16 largest companies, 3 is for companies with above $1 million net investment income, other than the 16 largest, and 4, companies with net investment income of $1 million or less.

The figures are shown, which I will read if you desire.

Senator CARLSON. I am confused a little bit with regard to tables 3 and 4. I believe it has been stated that these figures were based on 1942, but the note says: "Percentage of investment income required to meet policy interest requirements as computed in this table and in table 4 in accordance with the 1950 statutory formula." Now, are we looking at 1950 or are we looking at 1952?

Mr. SMITH. We are looking at 1950, Senator Carlson, in that only the basis for calculations on a company-by-company basis, which in turn is the basis for getting the industrywide average, is computed here on the 1950 formula.

Senator CARLSON. Thank you.

Senator ANDERSON. May I ask you this. On categories 3 and 4 he says, "Companies with above $1 million net investment income, other than 16 largest," they require 75 percent of their income. But the companies with a net investment income of $1 million or less need only 71 percent, 71.49?

Mr. SMITH. That is a really interesting difference.

Senator ANDERSON. The smallest ones aren't the ones that are in trouble, are they? It isn't the little companies that are in trouble, because they are allowed 77 percent each under the 1942, aren't they?

Mr. SMITH. They would be allowed 77 percent under the 1942 law.

Senator ANDERSON. They would be given 87½ percent under one law and 77 percent under the other, and all they need is 71 percent in any case?

Mr. SMITH. That is based upon the experience in this particular year, yes.

Senator ANDERSON. So that that would be relief—something strange, donation, I would call it.

Here in the U. S. News for March 7, an article entitled, "A Size-Up of Stocks by an Investment Counselor." In a speech February 15 at New York University, Armand C. Erpf made some comments. They asked him what was the future for drugs, he said that they would grow; they asked him about installment finance, he said that was pretty good, and they got on life insurance, and he said, "The miracle of compound interest works virtually free of tax bite over the years."

Now, to answer Senator Long's question, the reason that you have had trouble is that it is hard to work out a formula that the life insurance companies could take, because it is hard to find one that is free of tax bite. Isn't that true?

Mr. SMITH. That isn't our objective.

Senator ANDERSON. No, it isn't your objective. That is why you have opposed the stopgap legislation as permanent legislation, and I commend you for it, because if you pass this legislation and then try to put through a permanent law, they will say the level is now down to $280 million, and you want to raise it way up to $500 million, and that would be outrageous; whereas if you leave it at $415 million and then seek to go to $500 million, it wouldn't be quite so much of a raise. That is why it is so hard to get this legislation out, you just have trouble finding a formula free of tax bite. I know you are not trying to do that, but I know the people that are.

Senator WILLIAMS. Mr. Smith, in answer to Senator Frear's question a few moments ago, I didn't quite get clear one part of your answer. As I understand it, the Treasury thinks that the stopgap formula is better in regard to the manner in which it treats health and accident insurance; is that correct?

Mr. SMITH. That is correct, Senator Williams.

Senator WILLIAMS. Now, how do you feel about the manner in which the two formulas treat investment income? I understood you to say you would go along with it, but I would like to know your opinions on it.

Mr. SMITH. My recollection is, Senator, subject to correction, that the 1950 formula—excuse me, the 1955 formula, the stopgap formula—also includes a more reasonable method of taxing capital gains allocable to the health and accident business; capital gains are included in the definition of taxable income, taxable as capital gains.

That was one of the reasons that we preferred the present stopgap over an extension of the 6½-percent rate which was under consideration in 1955, when the present stopgap was first proposed.

Therefore, we like the 1955 stopgap better than the 1942 from that standpoint. It seems more reasonable to us.

Senator. WILLIAMS. If we decide to approve the stopgap formula, we would in effect be retroactively giving $124 million tax reduction to the life insurance companies; is that correct?

Mr. SMITH. They would pay that much less than they would if the law were not passed.

Senator WILLIAMS. And if we approve it with the 1950 formula for the companies up to $1 million, it would be retroactive, it would still be approval of $114 million——

Mr. SMITH. Based on my rough approximation of $10 million, yes.

Senator WILLIAMS. I think I was a little confused in that question there.

Senator ANDERSON. I think $114 million is too much.

Mr. SMITH. That fits, that is the $124 million less the $10 million which would be continued under the Senator's proposal.

Senator WILLIAMS. And the Treasury Department is recommending that we enact this stopgap, which would be either $114 million or $124 million, whichever way we decide it, retroactive tax reduction?

Mr. SMITH. I can only repeat that the Treasury will go along with an extension of the 1955 legislation.

Senator WILLIAMS. Do you think it would be advisable to do it? I know you would go along with it, because you would have to go along with it.

Mr. SMITH. To do no more than reiterate, we would go along with it.

The CHAIRMAN. What does "go along" mean?

Mr. SMITH. We do not object.

Senator WILLIAMS. It was suggested, I think, by Senator Frear, that perhaps in lieu of the stopgap formula, or going back to the 1954, the 1952 formula either, that we would adopt the 1950 formula and make it adaptable for the 1957 formula.

Senator ANDERSON. 1958.

Senator WILLIAMS. No. 1957. If the Congress was to substitute the 1950 formula retroactively to 1958, how much income would that be?

Mr. SMITH. The 1950 formula application to 1957 income would produce, our estimate is, $536 million.

Senator WILLIAMS. And if we left the existing law in effect, which is the 1942 formula, how much would that be?

Mr. SMITH. $415 million.

Senator WILLIAMS. And that would be a difference of $121 million retroactive tax increase; is that not true?

Mr. SMITH. That is right.

Senator WILLIAMS. Would not the Treasury so interpret that as retroactively increasing the taxes for 1957 if we were to do that?

Mr. SMITH. I would think so, because that has not been proposed or even considered—yes, I would regard that as retroactive.

Senator WILLIAMS. Would the Treasury oppose that on the basis that it was unfair in that it was a retroactive tax increase?

Mr. SMITH. I think we would; yes.

Senator WILLIAMS. Now, by this same line of reasoning, is not the adoption of the stopgap formula a retroactive tax reduction of $124 million?

Mr. SMITH. Except insofar as there has been obviously some consideration made formal on January 10, which was only a few days after the close of the year, and a considerable time before the tax return was due, of the extension of the formula.

Senator WILLIAMS. Well, would you consider that if this 1950 formula had on January 10 been made retroactive for 1957, that it would not have fallen automatically in the category of a retroactive tax increase?

Mr. SMITH. I would think I would say that is a matter of the degree of retroactivity, depending on dates.

Senator WILLIAMS. Is it not a fact that any tax reduction passed in the calendar year 1958 applicable to 1957 is a retroactive tax measure, whether it is an increase or decrease?

Mr. SMITH. I think at various times legislation has been passed after the close of the calendar year, but before the due date of the return.

Senator WILLIAMS. Now, could you give us one instance in which the Treasury has recommended, or in which Congress has passed, a retroactive tax reduction where the result was to reduce the taxes of a group by as much as 50 percent, or 25 percent?

Mr. SMITH. My experience, as the Senator knows, extends only over the last 5½ years, and in that period there has certainly not been any such instances. I don't know about earlier history.

Senator WILLIAMS. Then in your knowledge, this is the first time this has been proposed, that we would pass a retroactive tax deduction for such an amount?

I recognize we have extended the stopgap formula a time or two, but each time there has been a negligible amount involved. It has not been 40 or 50 percent, has it?

Mr. SMITH. The spread between the stopgap and the 1942 formula has been getting larger, you are correct.

Senator BENNETT. It has been larger in the past?

Mr. SMITH. No; it has been getting larger. It is now larger than it has been in any prior year.

The CHAIRMAN. You have clarified the Treasury's position, and I think it ought to be clear. I will read again what Mr. Mills said on the floor of the House:

> The Treasury Department has joined the committee in recommending the extension of the stopgap formula of H. R. 10021 to the year 1957 in preference to letting the 1952 formula apply.

I asked Mr. Smith a few moments ago if that was a correct statement, and he said it was.

Senator ANDERSON. Did the Treasury join in?

Mr. SMITH. I beg your pardon, Mr. Chairman, that was the statement that Mr. Mills made on the floor. I do not dissent from his interpretation, but Mr. Mills based his statement on the identical letter which you have, and I stand on that letter before this committee as I did in the Ways and Means Committee.

The CHAIRMAN. Maybe you didn't fully understand the question. The question was whether that was a correct interpretation of your position. I understood you to say yes.

Mr. SMITH. I thought the question was whether it was a correct statement, not a correct interpretation.

The CHAIRMAN. Exactly what is the position of the Treasury Department?

Mr. SMITH. The Treasury's position is that we will go along with an extension of the 1955 legislation. We will not object to it. On the other hand——

The CHAIRMAN. Wait 1 minute. You prefer, I think you have stated—or have you stated—that you prefer this stopgap to the 1942?

Mr. SMITH. I beg your pardon?

The CHAIRMAN. If you had to choose between the stopgap and the 1942 application of the law, then——

Mr. SMITH. As a method for permanent taxation?

The CHAIRMAN. No, as a method for dealing with the situation that now confronts us.

Senator BENNETT. For the year 1957?

The CHAIRMAN. For the year 1957.

Mr. SMITH. We prefer the method of the stopgap definition. We are not committed to particular rates.

The CHAIRMAN. Mr. Smith—I have a high regard for you, and always have had—but the situation we are in is due largely to the fact that the Treasury has not brought in its recommendations.

Now, the Congress must meet the condition as it now confronts us.

I want to know whether the Treasury prefers that no legislation be enacted, thereby going back to the 1942 formula, or whether it would be in the best interest of all concerned to enact the stopgap formula and then within 30 days have your recommendations which can be considered as a basis for 1958 taxation.

I don't think the Congress should have this burden thrown upon us entirely; we didn't create this situation. We have asked for 3 years now that you furnish the Treasury recommendations for a permanent tax formula. It is a very complex, difficult matter. I think it is probably the most complex taxation I have known in the 25 years I have been on the Finance Committee we have asked you repeatedly to do it, and you have failed to do it.

I think you should make the decision now and make it known as to whether you prefer to go back to 1942 or whether you think the stopgap formula (H. R. 10021) should be enacted.

Mr. SMITH. We would be content with either one, Mr. Chairman.

The CHAIRMAN. I don't think that is a very good answer, in view of the fact that the Treasury has created the situation that confronts us.

(The following letter was subsequently submitted by Mr. Smith clarifying the position of the Treasury in favoring enactment of H. R. 10021.)

TREASURY DEPARTMENT,
Washington, March 6, 1958.

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

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

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

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

Sincerely yours,

DAN THROOP SMITH,
Deputy to the Secretary.

Senator WILLIAMS. Well, there is a difference of 50 percent in the amount of revenue involved. Now, if you were to extend this over to all the tax structure of our country, you would certainly have to take a position. It seems to me, I think the chairman is right, you are either for it or against it.

Senator GORE. No, he isn't.

Senator WILLIAMS. I am inclined to agree with you, but I will say, he should be either for it or against it.

Senator ANDERSON. Don't you think you are asking the witness a lot in asking him to go beyond the written statement of his Department? He has no authority to do that.

Senator GORE. The committee might adjourn until the Treasury can make up its mind.

Senator ANDERSON. The Treasury has indicated that it will go along, it won't oppose it. But certainly it is not going to be happy about losing the $124 million.

Mr. SMITH. I will add this one additional point, as was made clear in the House floor discussion on this, and as we affirm now, in preparing the budget for this year, the revenue estimates, we assumed that the stopgap would be extended; we assumed that there was sufficient uncertainty as to whether the 1942 formula would be put into effect.

We did not include the additional revenue from the application of the 1942 law in our revenue estimates.

The CHAIRMAN. Did the Treasury report to the Budget Director on this matter indicate that you would favor the stopgap?

Mr. SMITH. That was our appraisal of what was thought was the likelihood. And in order not to make an unduly optimistic assumption we did not include it.

Senator WILLIAMS. During the calendar year 1957, did the Treasury Department at any time send in a recommendation to Congress dealing with this subject, either as to the extension of the stopgap——

Mr. SMITH. No, we did not.

Senator WILLIAMS. Were there any bills introduced in the House dealing with this question during the year 1957?

Mr. SMITH. To the best of my recollection; no. But I am not sure of that.

Senator WILLIAMS. Then what prompted you to think that something was going to be done unless you were going to recommend it? How did you arrive at the conclusion something was going to be done, because the existing law was the 1942 formula, and if there had been no measures introduced during the session, and if you had made no recommendations, there must have been something back of it somewhere that gave you reason to think it would be extended.

Mr. SMITH. We gave it a great deal of discussion. We assumed bills would be introduced based upon what happened in the past.

Senator LONG. What I can't understand, Mr. Smith, is that on various hardship measures, even where there is only a relatively small amount of revenue involved, the Treasury has taken the position that they were against any tax reduction whatever time and again, notwithstanding that they recognized a very heavy hardship, and that the matter involved in some instances only amounted to perhaps a few hundred thousand dollars.

Now here we have one that involves over $100 million, and these taxpayers are not those who are subjected to hardship, and yet the Treasury here is willing to go along with a measure that would continue a low rate of tax that would lose the Treasury $100 million.

Mr. SMITH. On a 1-year basis.

Senator LONG. It is still over $100 million. That is a lot of money, $124 million.

Senator CARLSON. While the Treasury may be accused of negligence in this case, is it not true that in the year 1957 you held many conferences and meetings with people affected in trying to work out something?

Mr. SMITH. We have not been idle on this subject, Senator; we have been far from idle on this subject. I thank you for the inquiry.

The CHAIRMAN. Are there any further questions?

Senator GORE. I would like to ask one or two, Mr. Chairman.

Mr. Smith, is there any insurance company within your knowledge that cannot meet the obligations now imposed upon it with respect to tax liability?

Mr. SMITH. I don't know that I am a competent person to answer that question. My answer, of course, would be "no," within my knowledge. But I take it the industry witnesses that will be before the committee will indicate such special situations as may exist.

Within my knowledge; no.

Senator GORE. Do you know of undue hardship that would be imposed, or that is imposed, by the present tax law?

Mr. SMITH. The statistical supplement and the verbal material that went with it indicated the varying impacts of the 1942 formula as compared to the stopgap that has been in effect for the last 2 years.

Senator GORE. That is not an answer to my question, though, Mr. Smith.

I asked you if you were aware of any undue hardship under the present law, which is the 1942 law.

Mr. SMITH. Hardship? No; I am not aware of any.

Senator GORE. Then upon what basis did the Treasury agree to "go along" with the so-called stopgap bill?

Mr. SMITH. Because it seemed to us not unreasonable, in what we hope will be the last year for an interim form of legislation before the adoption of what we hope will be a permanent formula, to have a continuation of what has been in effect in the 2 preceding years. To repeat, it would not be unreasonable, rather than adopt a still substantially different method with differing impacts upon different companies, for a single year.

Senator GORE. Do you mean to say by that that the present law, the 1942 formula, is unreasonable?

Mr. SMITH. I do not say that.

Senator GORE. Do you say it is or is not unreasonable?

Mr. SMITH. I say it would not be unreasonable to continue a stopgap for 1 more year.

Senator GORE. Well, would it be unreasonable to allow the insurance companies, to permit them, to require them, to pay their taxes, their tax liability, as levied under the present law?

Mr. SMITH. Not to my knowledge. That would not be unreasonable either.

Senator GORE. Neither would be unreasonable?

Mr. SMITH. That is my opinion, sir.

Senator GORE. And it is upon that basis that you come to the Congress of the United States, after these years of study, without a recommendation either that the bill be passed or that it not be passed?

Mr. SMITH. That is correct.

Senator GORE. Did you ever hear of a quotation "I would that thou wert cold or hot. So because thou are lukewarm, and neither hot nor cold, I will spew thee out of my mouth."

Mr. SMITH. If the Senator means to imply that he has terminated, I would welcome that implication.

Senator FLANDERS. I would like to ask the Senator from Tennessee how he would vote on that quotation?

Senator GORE. Well, I think that is a matter of action rather than voting.

The CHAIRMAN. Are there any other questions of Mr. Smith?

Thank you, Mr. Smith.

If you will stay in the room, there may be some other questions.

Mr. SMITH. Thank you for your indulgence on my very bady voice.

The CHAIRMAN. The Chair submits for the record at the request of Senator Samuel J. Ervin, Jr., a letter from Mr. Tully D. Blair, president of Security Life & Trust Co., Winston-Salem, N. C., favoring H. R. 10021.

(The letter referred to follows:)

SECURITY LIFE & TRUST CO.,
Winston-Salem, N. C., February 25, 1958.

HON. SAMUEL J. ERVIN, JR.,
Senate Office Building, Washington, D. C.

DEAR SENATOR: We note that the extension of the 1955 Mills law for Federal taxation of life insurance companies to cover the tax year 1957, passed by the House upon recommendation of the Treasury Department, has run into some difficulty in the Senate Finance Committee, with the result that a hearing has been set for next Tuesday, March 4.

As enacted for the year 1955 and then extended to cover the tax year 1956, the Mills law superseded the 1942 law but did not repeal it. Unless Congress extends the Mills law or adopts other legislation, the 1942 law will apply to the tax year 1957. That would result in an unreasonable increase, estimated at 40 percent of the Federal income tax imposed on life-insurance companies.

The 1942 law increased the tax on life-insurance companies from 1.4 percent of aggregate investment income to 2.8 percent, a jump of 100 percent. However, by 1947 it was producing no revenue at all. In recent years the 1942 formula has reversed itself in the direction of a confiscatory tax.

In 1950 under a stopgap law the total tax paid was 3.9 percent of aggregate investment income, an increase of 39 percent. From 1951 to 1954, inclusive, the tax rose to 6.5 percent, an increase of 66 percent, and in 1955–56 under the Mills law it rose again to 7.8 percent, another 20 percent increase. Of course, during this same period the corporate income tax rate was also increased from 38 to 52 percent.

All of these increases have brought about a situation where the institution of life insurance is now paying about twice as much in taxes as other thrift institutions, such as mutual savings banks and savings and loan associations.

The life-insurance companies have cooperated fully with the Treasury Department and are supporting the Mills law as the best solution to a fair and equitable basis of taxation. It will provide a stable and substantial source of revenue not subject to violent fluctuation, as was the case under the 1942 law, and also a steady increase from year to year as the business of life insurance grows.

We sincerely hope that you will see your way clear to support the Treasury-recommended extension of the Mills law so far as the tax basis for the year 1957 is concerned. This is a vitally important matter for the life-insurance companies and their nearly 110 million policyowners.

With best personal regards,

Yours sincerely,

TULLY D. BLAIR, *President.*

The CHAIRMAN. The next witness is Mr. Deane C. Davis, president of the National Life Insurance Co.

STATEMENT OF DEANE C. DAVIS, PRESIDENT, NATIONAL LIFE INSURANCE CO., MONTPELIER, VT., ACCOMPANIED BY CHARLES A. TAYLOR, PRESIDENT, LIFE INSURANCE COMPANY OF VIRGINIA, RICHMOND, VA.; CLARIS ADAMS, EXECUTIVE VICE PRESIDENT, AMERICAN LIFE CONVENTION; AND EUGENE M. THORÉ, VICE PRESIDENT AND GENERAL COUNSEL, LIFE INSURANCE ASSOCIATION OF AMERICA

Mr. DAVIS. Mr. Chairman, I have here with me Mr. Taylor, Mr. Adams and Mr. Thoré.

The CHAIRMAN. Are all of you going to testify together?

Mr. DAVIS. I will have a statement to make, and Mr. Taylor, Mr. Thore and Mr. Adams will appear with me.

The CHAIRMAN. Mr. Davis, you may proceed.

Will you identify yourself, please, sir.

Mr. DAVIS. Mr. Chairman and members of the committee, I am Deane C. Davis, president of the National Life Insurance Company of Montepelier, Vt. That is the mutual company that Senator Flanders so eloquently portrayed his love of connection with. 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 over 96 percent of the legal reserve life insurance outstanding in the United States.

Appearing with me in behalf of the joint tax committee is Mr. Charles A. Taylor, president of the Life Insurance Company of Virginia, Richmond. We are accompanied by Mr. Claris Adams, executive vice president of the American Life Convention, and Mr. Eugene M. Thoré, vice president and general counsel of the Life Insurance Association of America.

On behalf of myself and my colleagues, I would like to express to the members of this committee our deep appreciation for the courtesy you have accorded us in granting a speedy hearing. The importance of resolving these issues without delay is apparent since, in the absence of new legislation before March 15th—less than 2 weeks away—we shall revert automatically to a basis of taxation which was adopted over 15 years ago and which was abandoned as a proper formula nearly 10 years ago.

Senator ANDERSON. Have you any idea why?

Mr. DAVIS. Yes, sir, and I propose to tell why. And I should also like at this point to depart from my prepared text for the purpose of making a comment concerning the discussion which I have heard here as I have sat in this room over the question of whether the Secretary of the Treasury is making a recommendation for the passage of this stopgap bill or not.

And while I can recognize the concern of members of this Senate Finance Committee to know what that position is, and while it seems to me that that letter which was read, written by the Secretary, is entitled to only one interpretation, if in the minds of any of you it is entitled to more than one interpretation, I would like to say that all of my information is that the Secretary of the Treasury himself ap-

peared before the Ways and Means Committee and recommended the passage of the stopgap bill.

And I should also like to say that we sent for the record and it will be placed here in your hands, and it should show the fact about that.

Now, gentlemen, I would like to assure you that there is nothing that the life-insurance industry wants and needs more than an early solution and enactment of a permanent formula. We are weary and unhappy with the frustrating difficulties of managing our individual life-insurance companies amid the uncertainties and the apprehension which result from the inability to know from day to day what our tax liabilities are.

Senator ANDERSON. You said the Secretary appeared before the House committee. Then there were hearings?

Mr. DAVIS. There were general hearings, Senator, in January.

As it is, we do not know what our surplus is at the end of the year, nor what dividends we can safely distribute to policyholder. These uncertainties affect nearly all the phases of our planning.

On the other hand, we are just as anxious that this permanent solution shall be one that is sound in principle, workable in practice, and will fall with as nearly equal impact upon all of the policyholders of all companies as is humanly possible.

I have attached to this statement a chronological résumé of the history of the various acts since 1942. It may be helpful for reference, and is inserted for that purpose. It does show, however, something I should like to point out at this time—that the life-insurance industry has sought diligently and persistently to aid the Treasury and the staff and committees of Congress in their difficult task of finding a sound and permanent solution to this vexing problem.

It also shows that this has been a very active legislative problem which has occupied the attention of the Congress, the Treasury and the industry for over 10 years. (See p. 48.)

And, gentlemen, in view of that situation, I depart from my text to say that I hope somewhere in this hearing that the consideration may turn to the question of what is the fair measure of tax between these various tax possibilities and not be confined to the question of whether or not the Government is going to get $124 million more under one than the other of these bills.

On behalf of my mutual policyholders, I believe we have a right to ask that Congress look at it from that point of view.

Senator ANDERSON. Could you help us again? We are looking for the printed statement of Secretary Anderson. We don't seem to have a trace of it out here. Would you again identify the printed document?

Mr. ADAMS. On the sixteenth day of January he appeared before the Ways and Means Committee to make several remarks, and included this among them.

Mr. THORE. The record is not printed, Senator.

Mr. DAVIS. In 1947, when it appeared that because of the artificialities of the 1942 formula no tax would be payable, the life-insurance companies on their own initiative, requested a conference with the Treasury to discuss the development of a more satisfactory method of taxation. During the whole long course of the 10 years since 1947 the record discloses the continuing search for the solution.

In 1955, at the request of the Honorable George H. Humphrey, Secretary of the Treasury, the life-insurance industry made available to the Treasury the services of five distinguished actuaries who were familiar with the life-insurance business and could provide technical assistance.

It was understood that these actuaries would be acting as individuals in a professional capacity and not representing their companies or the life-insurance organizations. As a result of these arrangements, these five consultants attending a series of meetings with the Treasury, members of the staff of the Joint Committee, and the House Committee on Ways and Means, beginning in January of 1956 and ending in June of 1956.

All requests for assistance were fulfilled. Although available, they have not been called for consultation since June of 1956. These consultants are still available and are ready to offer their assistance in connection with any technical problems the Treasury or others might encounter in the development of a proposal. The availability of these men is only one example of the fact that during this long period the companies have sought to aid and not to hinder the search for a permanent solution.

Many people seem to think of the life-insurance industry as an aggregation of big business. For that reason, it is easy to overlook the fact that there is no business of any kind where the taxes imposed on a corporation, both State and Federal fall more directly upon the individual and upon more small people than in the case of life-insurance company taxes.

The life-insurance industry is made up of some 1,200 different companies—large, medium, and small—but the overwhelming majority in number is small. This is true even though the business does contain a number of very large companies.

Numerically, the largest number are stock companies but due to the peculiarities of this particular business, mutual organizations have always been predominant in the field, as evidence by the fact that over two-thirds of all of the life-insurance business in force today is written by mutual companies and they hold approximately 70 percent of the savings of all policyholders. For 35 years Federal income-tax laws applied both to stock and mutual companies have been based on tax principles deemed appropriate to mutual enterprise.

As you know, mutual companies are purely cooperative, nonprofit institutions. In a real but not in a strictly legal sense, they act as trustees for their policyholders and any tax levied upon them bears directly and immediately upon the policyholders.

It is essentially a personal tax on their savings collected through the corporation. Mutual life-insurance companies have no independent capital. The premiums they receive are merely capital contributions by policyholders to a common fund. These capital contributions are redistributed by the company either in the form of benefit payments or gradually over a long period of years through what are called policyholder dividends.

These so-called dividends are not dividends in the accepted sense, they are merely refunds of policyholders' money which, based on year-to-year experience, has been found not needed to carry out the contract obligations. The only income actually created is the income earned

on the capital funds contributed by the policyholders and invested by the company.

That principle was first established in 1921, as shown by the report of the Senate Finance Committee of that year.[1]

That principle has been given effect in every life-insurance income-tax law since 1921. The final effect of any tax on such investment income is to diminish the amount of insurance protection or to increase the cost to those protected. Thus the principal question to be resolved in developing a permanent tax formula is, to what extent the investment income on these policyholders savings should be taxed.

I should like to make it abundantly clear that our industry is not seeking preferential treatment. We believe that life insurance should bear its fair burden of the cost of supporting Government. It has been amply demonstrated in 45 years of experience that it is a difficult if not impossible task to fit life insurance into the pattern or the philosphy of the general corporate income-tax law.

The corporate income tax is a profits tax, levied upon the annual operations of an enterprise. Many life-insurance companies, indeed the majority of the large ones, make no profit at all in the generally accepted sense.

All companies are engaged in what is fundamentally a long-term business. Life insurance operates on the law of averages. It is the very nature of averages that large numbers and an extended period of time are essential to their validity.

Annual statement figures therefore, are not a valid criterion of actual realizable gains because they reflect but a small segment of experience with a long-continuing liability. Recognition of these essential differences from ordinary corporations and the complexity of the problem is the first and necessary step toward the construction of a sound formula.

Personally, I have no hope that any formula can be found which will be completely logical and perfect in theory. I have complete confidence, however, that if the representatives of Government have the patience to consider the multitude of factors—and I mean actually consider them—bearing on this question, a formula can be found which will be geared to the unique characteristics of this complex operation, will be fair to policyholders in comparison to other forms of savings, and provide reasonable equality among policyholders of different companies That is as near perfection as we have a right to hope for in this imperfect world.

Whatever the approach ultimately adopted in the permanent formula, I am positive it should not be a legalistic approach. For example, on legalistic grounds it could be shown that mutual life-insurance companies should pay no tax whatever at the company level, since there is no element of profit. The life-insurance industry in the United States has never taken this position, and does not take it now, in spite of the fact that in Canada no income tax whatever is levied upon mutual life-insurance companies.

Notwithstanding their differences, both stock and mutual companies have been taxed upon the same basis ever since there has been an income-tax law. This has been sound tax policy and has been

[1] See hearinng before the Senate Committee on Finance (67th Cong., 1st sess.) on H. R. 8245 (1921), p. 83.

supported by the business as a whole. Whatever the differences between the companies in theory, both of these types of companies sell a similar product, to the same public, for an identical purpose, in a highly competitive market.

I, myself, am president of a mutual company, but I do not ask for a tax advantage over stock companies. I am not willing to concede, however, because there are stock companies and because the form of organization of a stock company permits the legalistic recognition of the profit concept, that therefore a tax law should be constructed which taxes as income something which in the case of a mutual company is not income at all, and thus imposes a substantially heavier burden upon the small savers who use life insurance than upon those who save through other similar savings institutions.

Senator ANDERSON. May I interrupt you? Are you willing to follow this same principle in other ventures as well?

Mr. DAVIS. Follow the principle——

Senator ANDERSON. What you have laid down here. In the agricultural field, for instance, there are mutual companies that sell agricultural implements without any profit, they handle binder twine, or grease, and so forth, and they pay no tax.

Mr. DAVIS. Yes.

Senator ANDERSON. Are you therefore willing to say that all privately organized capital structure businesses handling similar products shall therefore pay no tax because a mutual company pays no tax?

Mr. DAVIS. No, indeed.

Senator ANDERSON. Just in the life-insurance business?

Mr. DAVIS. If you will permit me, I would like to tell you why. And the reason is that three-fourths of all the assets, as I pointed out, are held by mutual companies, and two-thirds of all the business in force in the United States is held by mutual companies. Life insurance began practically through the mutual concept originally back in the old days, although the guaranty funds had to be put up in the early days, and this great business has grown up.

Then stock companies began to get in the business, and the difference between a stock company and a mutual company in the field of life insurance, the differences are far less than in the field of industrial enterprise, or the field of merchandising distribution. And the reason for that is that they couldn't stay in business unless they followed pretty closely the methods, the price, the services, the cost, that the mutual life-insurance companies follow.

Senator ANDERSON. Let's go back to your language:

> I am not willing to concede, however, because there are stock companies and because the form of organization of a stock company permits the legalistic recognition of the profit concept, that therefore a tax law should be constructed which taxes as "income" something which in the case of a mutual company is not income at all, and thus imposes a substantially heavier burden upon the small savers who use life insurance than upon those who save through other similar savings institutions.

Now, are you willing to carry that right on through your whole structure?

Mr. DAVIS. If it has the same application, certainly, Senator. But certainly it has no such application in the field of the private companies which are selling agricultural implements, in comparison with the operations——

Senator ANDERSON. You would have to admit that under the capital law these agricultural co-ops who are doing business don't have any profits at all, they just give it back as dividends?

Mr. DAVIS. That is correct, sir.

Senator ANDERSON. And out in Kansas cooperative is going into the oil-drilling business, and he has got pipelines, filling stations, and everything else. Now, he operates under a mutual basis. Would you exempt from taxation the oil because he gets it under parity?

Mr. DAVIS. Certainly not.

Senator ANDERSON. But you want to do it here.

Mr. DAVIS. Certainly I want to do it here, because in the first place it has been the policy of the Congress of the United States for 45 years, since income taxes came into being in this country, to tax mutuals and cooperatives alone on account of the competitive reason. And I say it is sound to do so. That is why I don't want to follow it throughout the—Congress has made this decision of policy, not the life-insurance industry, but we are not questioning the basis of that, sir.

Senator GORE. For your information, one member of this committee is going to reconsider that decision.

Mr. DAVIS. Certainly, and there is every reason why he should. But it does not follow, because I say what I have said here with reference to the impact of taxes upon a mutual life-insurance company——

Senator GORE. I am somewhat bemused by what you say here. Will you explain what you mean by the "legalistic recognition of the profit concept"?

Mr. DAVIS. The legalistic recognition of the profit concept, I think, comes into being when we get into this complicated base of taxing investment income in both mutual and stock, I mean the question—for instance, what I am trying to say there in part is this, Senator, that in a mutual life-insurance company I think it would be a legalistic approach to say that because of the form of their organization, from a purely legal point of view, it doesn't throw up profits for the corporation itself, that therefore they should pay no tax, that is what I am trying to say.

Senator GORE. Then the profit concept is a reality?

Mr. DAVIS. The profit concept? Certainly the profit concept is a reality, but it shouldn't be decided on a legalistic basis.

Senator GORE. In other words, the profits are there, the motive is there, the concept is real, but if Congress recognizes and levies taxes on it, it then becomes a legalistic recognition?

Mr. DAVIS. No; it is exactly the contrary. What I am trying to say, Senator, is that because a mutual life-insurance company does not legally throw up any profits which once earned move from the customers so-called over to the people who own the capital stock, thus there is in the corporation—legalistically there is no such thing as income in a mutual life insurance company.

On the other hand, there is creation of wealth by the holding of those funds on the part of the life-insurance company, the reserves which are invested, there is some creation of wealth.

Senator GORE. Well, in this sentence here, if I read it correctly, you refer on page 6 not to mutual but to stock companies. I will read it to you if I may:

I am not willing to concede, however, because there are stock companies, and because the form of organization of a stock company permits the legalistic recognition of the profit concept * * *

You say now you were referring to the mutual. I understand—

Mr. DAVIS. No; you asked me what I was referring to on the legalistic end of it, and I said I was referring to both ways, both mutual and stock.

Senator GORE. I hope I am not trying to pressure you. This phrase which I asked you to interpret for me is a part of the sentence which I read.

Mr. DAVIS. Yes, sir. You would like to have me interpret for you the sentence which you read a moment ago?

Senator GORE. No; I am willing for you to go ahead with your statement.

Mr. DAVIS. I was going to suggest that to you, Senator, because I think it will be perfectly clear what is intended thereby.

Senator ANDERSON. I picked out from a newspaper of March 2 a statement, the only one I saw, of the Republic Life Insurance of Dallas, Tex. They have capital stock paid up of about $1,400,000. Their statement shows that their net investment income and capital gains last year was $3,807,643.36. You would recognize that as a fair return on the capital within the legalistic recognition of the profit concept; wouldn't you? If they get $3 million investment income they are not doing too badly; are they?

Mr. DAVIS. Well, I should want to read their statement, Senator, before I answered any such question.

Senator ANDERSON. I hope we will be reading a hundred statements before we get through with it.

Mr. DAVIS. So do I.

Senator ANDERSON. The net gains from operations was $1,743,000. That isn't taxable, is it, in a life-insurance company?

Mr. DAVIS. What was the last figure?

Senator ANDERSON. Net gain from operations.

Mr. DAVIS. It is not taxable today under any law we have, either in a mutual company or a stock company.

Senator ANDERSON. And in the case of the company which the Treasury referred to a moment ago, in which only 59 percent of their investment income was needed for their purposes—what was the rest of it?

Mr. DAVIS. Well, Senator, if you would permit me to finish my statement, I would like to come back to that very point, if I may.

Senator ANDERSON. Very well.

Mr. DAVIS. The burden of taxes on life insurance has grown steadily heavier, except for brief periods when certain formulas, now discredited by experience, produced some illogical results. In comparing the tax burden upon life insurance with those now borne by other thrift institutions, it is necessary to consider both Federal and State taxes. This is so because State taxes on insurance premiums are unique and have no counterpart in tax laws applicable to mutual savings banks, savings and loan associations, or other types of thrift institutions.

They are unique not only in respect to their magnitude but also their historical development and present status. These State and municipal taxes imposed upon life-insurance companies, as a result of this

unique history, aggregated $257 million in 1956, practically the same as the total of all Federal income taxes paid for that year.

Historically the life-insurance business has been supervised or regulated by the States and not the Federal Government, and was taxed accordingly. Until 1944 insurance was held to be not subject to Federal jurisdiction because it was not regarded to be commerce. During this era taxes for the support of the State supervisory process took the form of a percentage tax on premiums.

In the early days these tax rates were geared to bear some reasonable relation to the expenses of supervision. Today they are looked upon by the States as a legitimate source of substantial general revenue, and the actual cost of supervision is a mere fraction of the tax enacted.

As you know, in 1944 the Supreme Court reversed its position and held that insurance was commerce and was subject to the power of Congress to regulate. After thorough study and debate, however, Congress declined to accept jurisdiction, and in Public Law 15, passed in 1945, expressed the congressional intent to permit the States to continue their function of supervision and specifically validated their right to continue to impose these premium taxes, the legality of which might otherwise be open to question.

This history of taxation and supervision of life insurance underscores the close relationship of State premium taxes and Federal income taxes. In appraising the tax burden, neither tax can be considered without the other. They are part of an integrated system uniquely applicable to life insurance.

You have before you a green booklet entitled "Federal Income Taxation of Life Insurance Companies." If you will turn to page 26, you will there find a chart comparing the actual tax burden on mutual life insurance for the year 1955 with the smaller burden that would have resulted had it been taxed at the same level as mutual savings banks and savings and loan associations.

In the pages following the chart you will find a detailed account as to how the charts were made up and the comparisons produced. As you will see, the burden on life-insurance savers is 73 percent greater than upon the savers of these other institutions. These comparisons were made on the basis of the Mills law—which is what you have referred to this morning as the stopgap law—which fixed the actual taxes which the life-insurance companies paid for the tax year 1955. If either the 1942 act or the 1950 act should be reapplied, the additional burden upon life insurance as compared with other similar thrift institutions would be tremendously increased.

In saying as I did earlier that life insurance should not escape taxation, I do not mean that Congress should not give weight to the social and economic significance of life insurance. Congress hitherto has always done so and has recognized the importance of encouraging this form of thrift because of its substantial contribution to the economic growth and soundness of our private enterprise system.

In both Great Britain and Canada, which with the United States have the most highly developed life-insurance systems in the world, recognition of the social significance is given in even greater degree than in the United States. In Canada, for example, no income tax whatsoever is imposed upon mutual life insurance companies.

Senator ANDERSON. How does it treat stock companies?

Mr. DAVIS. If I remember correctly, it treats stock companies in Canada on the basis of the tax, that amount of money which is segregated from policyholders surplus goes into a fund called stockholders surplus, and at that point and only at that point it becomes available for distribution as dividends, and that is taxed at their going rate—on what is set aside for stockholders.

In Great Britain the policyholders are given a personal income tax deduction of 40 percent of premiums up to one-sixth of individual income. We are informed that the revenue loss by reason of that deduction alone is greater than the aggregate tax which Great Britain levies upon life-insurance companies. If such a deduction were granted in the United States, the result would be the same.

There are well over 100 million people in this country who are participating in this cooperative endeavor through legal reserve life insurance. Together they are providing protection of over $400 billions of life insurance. This large aggregate coverage, however, averages less than $4,000 per individual policyholder and approximately $7,600 for each family in the country, but a significant point is that only 20 percent of the adult population has coverage in excess of $5,000 and less than 10 percent has over $10,000. Life insurance is a big business carried on by and for little people. There are, of course, a substantial number of sizable policyholders, but the overwhelming majority are small savers.

The average family in this country contributes only about $16.50 per month for life insurance and annuities. The accumulated savings represented by life insurance and annuity reserves total roughly $1,400 per family; 72 percent of the families of America with less than $3,000 per year income, are owners of life insurance. In the overwhelming majority of cases life insurance constitutes the greatest part of the families' savings.

These figures are not cited to support a claim that these small savers should pay no tax. Equity requires, however, that in the process of applying a corporate tax at 52 percent to the earnings on policyholder savings, recognition be given to the fact that a very large percentage of all policyholders would pay no tax at all if the tax were assessed at the individual level.

I understand that in your discussions it has been tentatively suggested that the 1950 law be reenacted at this time to apply beginning with 1958. You can perhaps understand our surprise when we heard of this suggestion, in the light of the fact that the 1950 law was abandoned by the Senate Finance Committee the very next year after its enactment because it was considered to be so intricate and complex and obviously threatened to impose an unreasonably heavy burden on policyholders. Again in 1955, after painstaking and thorough study, it was rejected by the Ways and Means Committee.

Senator ANDERSON. I think it might be pointed out to you that the suggestion was made that if they passed the 1950 law for 1958, it might be possible to get a proposed law before us. If the stopgap legislation is enacted year after year at about a $200 million level, the life-insurance companies would be feeling no pain, and wouldn't worry about a new law; but if you put it up to $500 million, I think the author of the proposal said they would come in pretty quickly.

Mr. DAVIS. Who would come in?

Senator ANDERSON. The people who want to put the law through the Treasury would—the life insurance companies—you don't think they would, you don't think that if the so-called Kerr proposal that was agreed on by several people were reported out by the Senate Finance Committee the life insurance companies would object?

Mr. DAVIS. Every life insurance company in the country would object.

Senator ANDERSON. That is exactly what the author thought. Then they would get a permanent bill through. Obviously we can't get a bill under the present circumstances.

Mr. DAVIS. May I point out that the Life Insurance Association has no control over this except to help the committees of Congress and the Treasury. I may point out to you that we made available to Secretary of the Treasury George Humphrey five of the most distinguished actuaries of this country, and they were given specific instructions that they were to do everything they could, they supplied a tremendous mass of material.

But we are dealing here with—I am not either defending the Treasury or indicting the Treasury—I am saying that we have not been responsible in the slightest degree for the delay in this formula. But it isn't only the Treasury, they have been trying to produce a satisfactory formula ever since 10 years ago, when this very law of 1942 which has been described here while I have sat in this room as the law that was in effect—and technically it was——

Senator ANDERSON. It is in effect.

Mr. DAVIS. It is in effect.

Senator ANDERSON. It is the law.

Mr. DAVIS. But it was given up by Congress over 10 years ago, it has been repudiated, and the reason it was first repudiated was that for 2 years it wouldn't return any income.

Senator ANDERSON. Where do you suppose they got the idea, out of the Treasury itself, or the life insurance companies?

Mr. DAVIS. The 1952 act?

Senator ANDERSON. Yes.

Mr. DAVIS. A combination, just like every act has been. But is it right for the life insurance industry to draw the statute under which it is to be taxed?

Senator ANDERSON. I think we will get an answer to that when we get to work in the committee. I assume then that you don't want the life insurance companies to make any suggestions.

Mr. DAVIS. I certainly do want them to make suggestions, and we are making a few here that we think are very pertinent to the matter.

Senator ANDERSON. I was merely explaining to you why the 1950 law was proposed. I think the suggestion was made that if we put that in, there would be some desire to get permanent legislation passed.

Mr. DAVIS. Then it would be true that next year at this time when we had done everything we could to escape the burden of such an unjust, unwise tax as that, would it be said that it was in force technically and therefore we had no right to have a decent tax because it had stayed in effect for this year ahead?

Senator ANDERSON. For 1958, yes, I think it became the law of the land, just like I think—do I understand that you do not believe that the 1942 law is the law of this land for insurance companies.

Mr. DAVIS. Of course it is the law of the land.

Senator ANDERSON. Then what are we arguing about?

Mr. DAVIS. What I am saying is, you are suggesting that in 1958 it is our interest to have the thing passed even though it will never be effective.

Senator ANDERSON. I am not suggesting that at all.

Mr. DAVIS. I am sorry, I misinterpreted your statement.

Senator ANDERSON. I will try to get it to you again. If you passed a law that raised the taxes to $536 million, the life insurance companies might come down and help Congress devise new legislation that was fair?

Mr. DAVIS. Can we help Congress write that now, Senator? Because we are ready to pledge everything we have got in the way of manpower and everything else, if you will just tell us what to do. We just love to do that.

Senator ANDERSON. Providing it doesn't cost anything.

Mr. DAVIS. No, I am not providing that. We are paying now more than savers in other institutions, and we have accepted that, we have accepted the Mills law philosophically and reluctantly, even though it is a greater basis, because we think it is the best thing that has been produced, and at least it is one law that has been considered. It is the only law that has had deep consideration for years, as shown by the records.

And to jettison that law now and put into effect the 1950 law or the 1942 law, both of which have been repudiated, I can just not go along with that.

Senator ANDERSON. The 1942 law is in effect. Are you in doubt about that? Talk to a lawyer and see whether it is in effect.

Mr. DAVIS. Well, I practiced law and was on the bench for a number of years, so I think I am competent to say that it is in effect.

Senator WILLIAMS. What you are really speaking about is jettisoning the 1942 law and putting something else in?

Mr. DAVIS. No, I am not. The reason is this, that the Mills law——

Senator WILLIAMS. I am not referring to that, I am referring to, you recommend that we discard the existing law?

Mr. DAVIS. No, what I am saying is that the 1942 law has never been applied once since 1949.

Senator WILLIAMS. I am not defending the 1942 law as being an equitable formula. But if the 1942 law was applied effectively January 1, 1957, then it has been in effect for the past 14 months, is that not correct?

Mr. DAVIS. It has been in effect technically, of course, the last—how many months?

Senator WILLIAMS. What is the difference in being in technical effect?

Mr. DAVIS. There is no difference from what it was a year ago, and a year before that; it was in effect during that period, and then you passed stopgap legislation.

Senator ANDERSON. I don't think that statement should be made.

Mr. DAVIS. Certainly it is true.

Senator ANDERSON. Is it?

Mr. DAVIS. Yes, indeed.

Senator ANDERSON. When did the so-called stopgap legislation come up for the year 1956? Did it come in July, 1956, during the then existing year?

Mr. DAVIS. Yes, indeed.

Senator ANDERSON. Well, isn't that a little different from what he is talking about?

Senator WILLIAMS. It was proposed in 1955.

Mr. DAVIS. That is right.

Mr. ADAMS. It was proposed and passed in 1956 at the end of the year after the 1942 law had been technically in effect.

The CHAIRMAN. For the purpose of the record I think you had better identify yourself.

Mr. ADAMS. My name is Claris Adams. I am executive vice president of the American Life Convention. I was only trying to be helpful.

Senator FLANDERS. I would suggest, Mr. Chairman, that Mr. Thoré be introduced personally, also, so that if he goes on the record it will be known.

Mr. THORÉ. I am Eugene M. Thoré, vice president and general counsel of the Life Insurance Association of America.

Mr. DAVIS. Senator Williams, if I might, without laboring this point, I will say that what I mean by jettisoning the Mills law is that that is the effect at this time by either action or nonaction on the part of Congress, because the Mills law was offered as a permanent formula.

Senator WILLIAMS. But the Mills law is not a law; the Mills law is only a bill proposed to repeal the existing law and substitute a new formula.

Mr. DAVIS. I understand that.

Senator WILLIAMS. I am not a lawyer, and so it is far from me to tell you, but, certainly, the law is an existing law and is not a bill which is pending before the committee. And, when you speak of the existing law as being just a technical provision, I think you are wrong.

Mr. DAVIS. Well, perhaps I am overimpressed with the long history that appears, not only in this appendix, but everywhere else. But in June of this very year, 1957——

Senator WILLIAMS. That is last year.

Mr. DAVIS. Excuse me; last year, 1957—we went to Mr. Mills at that time, whom we regard today as one of the few men in the House who have really gone to the bottom of this thing for weeks and weeks and months and months of study, and showed him the situation that the Treasury had not yet brought in their formula, which, I think you will recall, is the reason why the Senate Finance Committee took the action they did in passing the Mills bill as what they called stopgap legislation the first time applicable to 1955 business.

Now, then, it comes along, and we have waited these 2 years, and we have not received, the public does not know of—all we do know is that there has been enough talk so that we suspect and believe that the Treasury Department believes in what is called the total-income theory, which hits the point that the Senator raised as to the inclusion of underwriting income in the tax base.

Senator WILLIAMS. But the point that is bothering some of us is not that we are defending the 1942 formula—I don't think that is the correct answer—but whether or not we should establish the prin-

ciple of passing a retroactive tax-reduction bill, because, if we can pass a retroactive tax-reduction bill, and accept that as being proper, we can, by the same token, pass a retroactive tax-increase bill.

I happen to be one that has always questioned the wisdom of any retroactive tax measure, as such, and that is concerning some of us; we are not debating the merits between the 1942 and the 1955 formula, nor is it the mere question that under one we would get $124 million more than the other, but we are dealing with the principle of whether we wish to adopt, naturally, the right of Congress to retroactively here in March pass a retroactive tax measure, and, if we reduce your tax by 50 percent without it being any violation of a principle, we can increase it, likewise, 50 percent.

And if we decide to adopt the 1955 formula—which I am not suggesting—but suppose we did decide to adopt the 1955 formula retroactively for all of 1957, which produces about $50 million more than even the 1942 formula, would you not criticize that as being a retroactive tax increase?

Mr. DAVIS. I would criticize it, not upon the ground of retroactively, but upon the ground of the manifest inequity of the bill itself, both as to burden and the method that is to be applied.

Senator WILLIAMS. Then do I understand that if, perchance, we could persuade the Treasury Department to reduce this 30-day period, and they would submit a plan down to us, and we could work out something in the Congress on it, and even though it provided 50 or 100 percent increase in tax liability, and we enacted that before March 15, you would not object to it on the basis of tax retroactivity and increase?

Mr. DAVIS. That is quite a different thing, I think, Senator.

Senator WILLIAMS. I think it is the same thing. I think we are dealing with the principle of whether we should increase taxes retroactively or decrease them. Personally, I would oppose the imposition of a 1950 formula or any other formula which increased your tax over the law of 1957. There is a great question in my mind as to whether we should reduce them.

Mr. DAVIS. Let me point out to you, Senator, if you are concerned about this question of the right to retroactivity, that this is exactly what Congress did in January of 1950.

Senator WILLIAMS. No; there is a difference. In 1950, the law was passed—I don't know about 1950; I wasn't on the committee then—but in 1956—the law was introduced the year before, notice was given, and it was adopted by the committee in 1956.

Mr. DAVIS. I am now talking about 1950. And that was done without hearings before the Ways and Means, and it was reported as No. 371, applicable to the tax years 1947, 1948, and 1949.

Senator WILLIAMS. During those years, I understand, you paid no tax rates.

Mr. DAVIS. That is correct, by the application of this 1942 law, which, if you do not act now, will come back into effect.

Senator WILLIAMS. Did you approve that measure at that time when Congress passed the 1950 law, or did you oppose it?

Mr. DAVIS. In 1950, we all agreed with it.

Senator WILLIAMS. You mean you endorsed it and urged its enactment?

Mr. DAVIS. Some people objected.

Senator WILLIAMS. Did you, personally, endorse it?

Mr. DAVIS. I had nothing to do with it. I have been on the committee only 2 months.

Senator WILLIAMS. I wasn't on the Finance Committee then. Let's talk about existing things.

Mr. DAVIS. You are talking about retroactivity, and this is a precedent.

Senator WILLIAMS. I wonder if you approved of that precedent?

Mr. DAVIS. Yes; I did.

Senator WILLIAMS. And you say that, even at this late date, we would not be violating any moral principles if we passed a retroactive tax measure today under this law which, we will say, increased your tax liability over and above the 1942 act?

Mr. DAVIS. Not on that ground alone, sir.

Senator WILLIAMS. That is all.

Senator GORE. Mr. Davis has said to Senator Anderson that he was anxious to be helpful to the committee and to the Congress. He could be helpful to one member of the committee if he would address his remarks to the reasonableness of and the justification for this bill. He has read, thus far, a very illuminating statement giving us a good deal of history and comparison between this country and Canada and England, but he hasn't given us any reason why the present law is unreasonable.

Mr. Smith, Deputy Secretary of the Treasury, has just testified that the present law is not unreasonable. I do not know how I shall vote on this question, as of now. If the present law is unreasonable, if it imposes unbearable hardships, then I am ready to try to mitigate those hardships and inequities.

If the present law is not unreasonable, imposes no undue hardship, then I want somebody to give a sufficient reason why we should give tax reduction first to the insurance industry.

Now, if you can answer those questions, you would help one member of this committee.

Mr. DAVIS. Thank you, Senator, and I will try to do that. I will try to speak as closely to that subject as possible.

Let me say, in the first place, the reason why this law should not be passed is that the theory upon which it is based, as well as the application of it and the results, are completely unsound and discriminatory, and what——

Senator GORE. Are you talking about——

Mr. DAVIS. I am talking about the 1942 and 1950 laws because in the respect in which I am now about to direct my remarks, I believe in not the same degree, but in the same principle, the philosophic basis for these two are the same.

And if you will let me go on with my statement I think you will see that.

Senator GORE. I was not trying to be unpleasant to you. You have just said you were willing to help. I was trying to indicate how one member could be helped.

Mr. DAVIS. Thank you, Senator.

The basis of the 1950 act for measuring taxable income is unsound. This is also true of the 1942 act. Both of these acts are based in dif-

ferent degree upon what has come to be loosely characterized as the "excess interest" theory.

It had its origin in the recognition of the inescapable fact that any tax formula must provide, at the very least, for the elimination from the tax base of that portion of a company's investment income which under the law it is obliged to set aside for future payment to the policyholders. To include that portion of investment income within the taxable base would bankrupt every company in this country. This is true whether we are considering a mutual company or a stock company.

Senator WILLIAMS. Are you saying that to apply the 1942 act would bankrupt——

Mr. DAVIS. Not in 1 year, but what I am saying is, to include all of the interest required to maintain reserves. What this is is merely trying to point out the fact that this excess interest theory has been used for two things in the past, one—which I agree with, that you cannot invade the amount of reserve interest, interest required to maintain reserve—but two—the rest of interest is not a measure, a true measure, of taxation.

Senator WILLIAMS. And if the 1942 act were continued indefinitely, do you think it would bankrupt every life-insurance company in America?

Mr. DAVIS. I don't mean that.

Senator WILLIAMS. I thought that is what you said.

Mr. DAVIS. I didn't say that. I said, if you will notice, "to include that portion of investment income within the taxable base"—meaning the amount of interest that is required under the contracts to maintain——

Senator WILLIAMS. Is that includible under the 1942 act?

Mr. DAVIS. It is not includible under the 1942 act. I am merely talking to the theory.

Senator WILLIAMS. You are just talking about if we did something which is not in the act.

Mr. DAVIS. I am trying to explain the basis upon which the 1942 act was constructed, and to show you why in my opinion it was absolutely unsound.

Senator WILLIAMS. Go ahead.

Senator ANDERSON. Was that part of the theory, to take this portion?

Mr. DAVIS. It is part of the 1942 act, at least that portion of the 1942 act, the 35 percent that you heard Mr. Smith testify about this morning. To that extent the 1942 act is based on the industry average of interest required to maintain reserves.

The 1950 act, on the other hand, 100 percent of it is based on the industry average of interest required to maintain reserves.

Senator ANDERSON. Now, you were here when Mr. Smith was testifying. He introduced a table which shows the percentage of investment income needed to meet policy interest requirements.

Mr. DAVIS. Yes, sir.

Senator ANDERSON. And for all the companies, it is 0.7069. And now, what does the 1942 act recognize as an interest rate?

Mr. DAVIS. The 1942 act recognizes a flat 3¼ percent, I believe it is, for 65 percent, recognition of an interest rate, and the other 35 percent is the average of all companies.

Senator ANDERSON. What is this 74 percent figure that we have been dealing with?

Mr. DAVIS. If you will permit me to tell you what the philosophical basis of this interest theory is, I will try to explain it.

Senator ANDERSON. You have got a statement in here—

to include that portion of investment income within the taxable base would bankrupt every company in this country.

Mr. DAVIS. It is not included.

Senator ANDERSON. Nobody has included it?

Mr. DAVIS. No, but it is the very basis of the excess interest upon which the 1942 and 1950 acts came into being.

Senator ANDERSON. This is put in to try to scare everybody—

to include that portion of investment income within the taxable base would bankrupt every company in this country.

Has anybody proposed that?

Mr. DAVIS. I don't know officially.

Senator ANDERSON. You are testifying officially. Who proposed that? Who proposed to break every company in the country?

Mr. DAVIS. I don't know, sir.

Senator ANDERSON. Why did you put it in there?

Mr. DAVIS. I put it in there because it is clear that even you, Senator, have been quoted as saying that it was not necessary that this reserve interest be eliminated from the tax base.

Senator ANDERSON. Go on and tell me where I was quoted. We are not indulging in hearsay. Who said I said it? And where?

Mr. DAVIS. It was a matter of discussion when I first came down here a couple of days ago.

Senator ANDERSON. With me?

Mr. DAVIS. No; I haven't seen you.

Senator ANDERSON. Who did say it? You have put it in the record. Now will you tell me about it?

Mr. DAVIS. Well, to be honest with you, I don't believe I can tell you.

Senator ANDERSON. That is a good, honest answer, and it would have been better if you had put that kind of a statement out before you made the statement.

Mr. DAVIS. To understand why this is so, it is necessary to briefly describe the nature of a life-insurance policy, the necessity for policy reserves, and the relationship of interest earnings to the premium computation and the benefits promised.

The matter of reserves is one aspect of life-insurance operations which finds no counterpart whatsoever in ordinary business corporations. Many people think of a life-insurance policy reserve as being essentially the same as a contingency reserve for bad debts, for future tax liability, or any one of the many reserves for contingency which are commonly found in the balance sheet of corporations generally.

Nothing could be further from the truth. In an ordinary business corporation you set up your reserve as a liability, deduct it from your assets and find your net worth, and that is the end of it except to the extent that net worth may be increased or decreased in the future according to whether the liability is or is not determined by future events.

In life insurance the policyholder reserve is an inherent part of the system. It arises from the very nature of level premium life

insurance. The life insurace company collects the same gross premium each year. Yet everyone knows that the risk of dying is much less in the early years than it is in the later years.

Hence, in order to make it possible to have a level premium throughout the life of the policy, it is necessary to collect more than enough to carry the risk in the early years and not enough to carry the risk in the later years.

Having collected too much in the early years, what does the company do with it? It not only sets these yearly excesses aside, but it accumulates them in a fund to which it adds a specified interest increment each year. Without this invested fund and the earnings thereon, the company would not be able to meet its claims in later years when the premiums are inadequate.

Such funds constitute the policyholder reserves of a life insurance company. Hence this accumulated interest should no more be included in the tax base than should the interest which a corporation pays on its bonds or the interest credited by a bank on its savings deposits.

However, merely because it is established that that portion of investment income cannot be included in the tax base, it does not follow that all of the rest is the true measure of taxable income. Failure to distinguish between these two facets of the problem lies at the root of most of the confusion over the validity of the "excess interest theory" embodied in both the 1942 and 1950 acts.

The gyrations and fluctuations in the impact of the tax which these formulas have shown during this long period, wholly unrelated to corresponding differences in actual operating results, would seem clearly to demonstrate the impracticability at least, and, I personally believe, the invalidity of this concept as a measure of the tax.

In 1942, when the 1942 formula went into effect, the net investment income of companies was $1,164 million. The net investment income in 1957 is estimated at $3,716 million, an increase of 220 percent.

That is, investment income more than tripled over the intervening period of 15 years. The 1942 law produced taxes of $27 million in 1942, but in 1957 this law would produce taxes of $420 million, an increase of over 1,400 percent. While net investment income tripled, the impact of the tax became 15 times as heavy.

In 1950, when the 1950 law went into effect, the net investment income of life insurance companies was $1,935 million.

Senator GORE. Mr. Chairman, could I ask one question?

In the paragraph at the bottom of the page, to what extent would the revenue returnable by the terms of the 1942 act be affected by the high interest rate policy that has been in effect for the last 4 years?

Mr. DAVIS. It would be affected by that part, I can't tell you in dollars, of course, because it is an industry average, but it would be affected by the high interest rate, the difference between 3.44 and 3.63, Mr. Adams reminds me.

Mr. ADAMS. In 1942, the industry average interest was 3.44, when the 1942 act first came into existence.

Last year, it was 3.63. The rate of interest earned had gone up nineteen one-hundredths of 1 percent. It had gone way down in the meantime and it came back up.

Senator GORE. And can you supply for the record, since you do not have the figures at hand now, Mr. Davis, at this point the net effect on profits and the net effect on tax liability under the 1942 formula with respect to 1942, 1950, and 1957?

Mr. DAVIS. You mean the extent to which the change in the interest rate affected it?

Senator GORE. Yes, sir.

Mr. DAVIS. For the industry?

Senator GORE. Yes.

Mr. DAVIS. Yes, sir.

Senator GORE. In other words, you have used the figures here on revenue produced by the 1942 formula in 1942, and in 1957. I would like some intervening year, say, 1950, and then an explanation of the net effect of the change in interest rates on the changes in the amounts of revenue produced.

Mr. DAVIS. Yes, sir.

Senator GORE. Thank you.

Mr. DAVIS. In 1950, when the 1950 law went into effect, the net investment income of life insurance companies was $1.935 million.

In 1957, net investment income was estimated at $3,716 million, an increase of 92 percent, almost doubling the income.

The tax in 1950, according to the 1950 formula was $72 million. In 1957, the same formula would produce a tax of $542 million, an increase of 650 percent. In other words, while investment income doubled, taxes would be 7½ times as heavy.

Does one need further proof to demonstrate that there must be something wrong with a formula such as in the 1950 law—and I might here say the same thing with reference to 1942—which produces a 650 percent increase in the rate of tax basis upon a 92 percent increase in the rate of income.

Senator FREAR. I wonder if the basis might not have been wrong in the beginning, that you were undertaxed and not overtaxed in 1950 and 1952?

Mr. DAVIS. Whether that is so, Senator, it does seem to me to point up the fact that any tax law that can show such variations as that, at least is suspect.

Senator GORE. Mr. Davis, are you aware of the "gyrations" with respect to the tax law by a person whose income jumps from $20,000 per year to $80,000 per year?

Mr. DAVIS. Oh, but that is based upon a graduated income tax. This is based on a flat tax.

Senator WILLIAMS. Mr. Davis, your computation here on page 12 that you have just put in the record is all based upon 1950 law, and yet you said off the record that it would be the same thing applicable to 1942; but would there not be a difference in 1942 and 1950, because would not the 1942 formula be less than these figures which you are quoting?

Mr. DAVIS. I have got both of them in there, Senator; 1942 and 1950.

Senator BENNETT. If you will turn back to page 12, you will see that.

Senator WILLIAMS. All right.

Mr. DAVIS. Why are such results produced?

One of the important reasons is because these assumed rates of interest are only estimates for the future, not the actual results in fact. Because they are merely the measure of management decisions, not the

measure of actual interest earned. Because when experience later shows, as has often been the case, that these estimates of future interest earnings were too high, the companies must strengthen, and have strengthened, reserves in order to maintain safety, and the result is to artificially push down the required interest rate thereafter and to artificially broaden the tax base.

Under the "global theory"—and I mean by that the averaging theory—contained in the 1942 and 1950 acts, a further complication is introduced.

The rate of reserve interest credit now becomes not the actual figure which any one company used, but an average of the figures used by all the companies. So now we have a figure which is not even the enlightened guess of the company paying the tax, but a figure which is merely an average of all the enlightened guesses of all the companies, each individually made by each company in consideration of conditions pertaining in the particular company, but which vary widely between companies.

These expressions of opinion, differing among different men, made under different conditions in each company and at different times in accordance with estimates of future economic climate, do not have either the quality of definiteness or the accuracy of measure required to form the basis for a tax law.

As the Senate Finance Committee said in its report in February 1956, which approved the Mills law with amandments:

> It does not appear desirable that tax liability should depend on pure bookkeeping changes * * * [or] year-to-year variations in the reserve interest picture.

Once we adopt the excess-interest theory, we are cast on the horns of a dilemma:

Either we use the average reserve requirements of the industry and produce some inequities, or we use the individual reserve requirement of each company and produce many more inequities. Either approach is unsound because the basic concept is unsound.

There is one glaring inequity, even in the Mills law in its present form, which demands early consideration and action. Bad as it is under the Mills law as now amended, the inequity would be greatly compounded by the reenactment of the 1950 law or leaving the 1942 law as the law.

I refer to the matter of discrimination against insured pension and other annuities.

As you will recall, the Mills bill as it passed the House in 1955 contained provisions removing part of the inequity in the case of insured pension funds, individual annuity contracts, settlement options, and kindred categories. These particular provisions were deleted in 1956 by this committee without prejudice, because time would not permit hearings before the committee on the merits.

In the exhaustive hearings before the Ways and Means Committee, witnesses representing both insurance companies and small business pointed out that the tax paid by life insurance companies on that portion of investment income earned on insured pension funds created a discrimination against small businesses.

Small companies have no alternative but to insure their pension plans. Large companies, with a large number of employees, have

a choice in setting up their pension plans as to whether they will deposit their funds with corporate trustees or purchase annuities from a life-insurance company.

The trusteed method is available to large employers because with a large number of employees they can safely underwrite the mortality involved, since the law of averages will work for them with large numbers the same as it will for an insurance company.

This method is not open to small business with a few employees since all experience indicates that the underwriting of a precise level of mortality with respect to a few lives is a hazardous undertaking and would be a business decision bordering on gambling. But under existing laws, the large employer, by depositing the funds with a corporate trustee, completely eliminates the investment income from the Federal income tax.

On the other hand, if the plan is insured, the pension funds are depleted by the Federal income tax imposed on the life-insurance company.

The discrimination is further enhanced by the fact that when the large employer deposits his funds with the corporate trustee he further escapes the heavy taxation which the small employer must pay because his insurance company must in many States pay a State premium tax on every dollar of contribution which the small employer makes to the plan.

Is it any wonder that this discrimination against insured pension plans is causing a rapid shift of these funds to trust companies?

During 1956, total premium income on insured group pension plans for the first time showed a decrease, and this trend will continue as long as the present discrimination exists. If, as has been the fact, this trend has already come about under the Mills law, which taxes investment income on all such funds at 7.8 percent, it is obvious that a change to the 1950 act, under which the tax rate would be approximately doubled, would merely accelerate the trend.

Leaving out of consideration the competitive factors and the competitive advantage between trust companies and life-insurance companies as such, is there any sound reason why the tax policy of the Government should be to discriminate against the small employer and favor the large employer?

The actual effect of this discrimination is to reduce the pension benefits which can be offered by small employers compared to what can be offered by the large employers, and thus it is the employee who really bears the main brunt of this inequity.

In deleting the portion of the Mills bill which would grant relief in this connection, the Senate Finance Commitee reserved judgment on the merits.

Your committee, in its report to the Senate, said:

> Since time did not permit such a study, the provisions have been removed from this bill with the understanding that this question will be further examined by the Congress in connection with legislation for 1956.

It is to be regretted that the course of events during the last 2 years has permitted no opportunity to have that question heard on its merits. Certainly, under these circumstances, the existing burden of discrimination should not be aggravated by doubling the rate on these funds as would be the case under the 1950 law.

This is another reason why the Mills law should be continued in force until such time as full hearings can be held on proposals for permanent legislation.

Surely such hearings will include consideration of such matters as the discrimination against insured pension funds and the double taxation that results from taxing investment income earned on reserves in connection with individual annuities, settlement options, et cetera, at the corporate level and again when received by the policyholder, beneficiary, or annuitant.

Having in mind that a permanent formula——

Senator ANDERSON. May I ask you again about these words, "this is another reason why the Mills law should be continued in force."

Mr. DAVIS. I say it is another reason, Senator——

Senator ANDERSON. Is it in force now?

Mr. DAVIS. Technically, no; it isn't. Not actually in force. But that is the basis on which we were taxed for 2 years, and which we have been planning and expected was to be permanent legislation, and I believe would have been had it been heard at the time that it came to the Senate Finance Committee.

Senator ANDERSON. Then, just assuming that this is a little technical slip here when you say that the Mills law should remain in force, if it isn't in force, do you suggest that you shouldn't make any change until we have full hearings?

Mr. DAVIS. Yes.

Senator ANDERSON. Fine. Because this half-proposal——

Senator FLANDERS. I would suggest that the witness might be willing to use the words:

The Mills law should be reinstated until such time * * *

Would the witness be willing to change that?

Mr. DAVIS. Yes, I would be willing to change that.

I should like to explain, however, that I still think the word is properly used because for 2 years it has been the basis of taxation, and no company has paid a tax on the 1942 basis since 1946.

That is why I say what I mean, "in force."

Senator WILLIAMS. It has been in effect for the past 2 years, but for the past 14 months it has not been in effect.

Mr. DAVIS. Legally, that is correct.

Senator FLANDERS. It seems to me that this is a distinction without a difference, and we can avoid it by changing 3 or 4 words.

I would suggest that we do that.

Mr. DAVIS. I would be very happy to do so, Senator.

Having in mind that a permanent formula for the taxation of life-insurance companies must be forged in the months ahead, I urge you not to revive either the 1942 or 1950 laws, simply because additional revenue would be produced at this particular time.

Senator ANDERSON. I won't object to the word "revive," but it is an interesting suggestion.

Senator WILLIAMS. You are urging that they revive the 1955 law, is that what you are really urging?

Senator BENNETT. Mr. Chairman, it seems to me that this particular point has been made crystal clear, and it is obvious that when the witness wrote his material he was thinking from a slightly different point of view.

He has acknowledged his error, he has admitted the validity of the statements or the explanations made by several members of the committee, and I suggest that he be allowed to finish his statement, and whenever the question occurs, we can all make a mental note that he has changed his basic point of view.

Senator GORE. Technically speaking.

Senator ANDERSON. The last sentence, Senator Bennett, is "They were both abandoned by Congress years ago." I don't think that is a historically correct statement.

Senator BENNETT. Well, I have made my plea, Mr. Chairman.

Senator ANDERSON. All right.

The CHAIRMAN. I think it is fully understood, and I think we will make more progress that way.

Mr. DAVIS. These laws should not be considered as either permanent or temporary solutions to this vexatious problem. They were both abandoned by Congress years ago.

The legislative record behind the 1942 and 1950 laws can hardly be compared with the exhaustive studies by the House Ways and Means Committee in 1954 and 1955, which resulted in the introduction of the Mills bill. In 1954, the Ways and Means Committee appointed a subcommittee to study the matter. The staffs under the direction of this subcommittee developed a comprehensive 60-page preliminary statement of facts and issues.

I may say, I should like to compliment whoever wrote that statement that I referred to. I don't happen to know who it is, but I have read it with great, great admiration.

This statement reflected the independent studies of the staffs. In December 1954, a 3-day public hearing was held by the subcommittee to consider the staff report and the view of the life-insurance business and the public. The record of these hearings is almost 400 pages long.

Then in January 1955, the subcommittee made a 57-page report to the Ways and Means Committee, including a number of specific recommendations. This report and the recommendations were considered by the Ways and Means Committee and the Mills law was based on the conclusions reached.

Under these circumstances would it not be unwise to jettison the Mills law in favor of either the 1942 or 1950 law? It seems to us that until hearings are held on permanent legislation, failure to continue—and I will change that now to "put back into effect the Mills law"—would destroy the good accomplished by the labors of the Ways and Means Committee.

Reenacting the 1950 law—I will say "letting that 1942 law continue to be the law"—would substitute an unsound law which was discarded years ago—and I stand on the "discarded" statement.

Senator GORE. Do you stand on the word "substitute"?

Mr. DAVIS. What paragraph?

Senator BENNETT. The last sentence.

Senator ANDERSON. You just read it.

Senator BENNETT. "Reenacting."

Mr. DAVIS. Yes, I stand on that too.

In conclusion, we believe that any permanent law to be sound, must give effect to the following principles:

1. That the only proper taxable income in a life-insurance company is investment income.

2. The tax formula should be so constructed that the emerging taxes will fluctuate from year to year only in reasonable relationship with such income.

3. The tax must not be so high that any life-insurance company will be unable to maintain its reserves in accordance with the requirements of State regulatory law.

4. The tax should not be so high as to prevent any company from maintaining reasonable margins of safety above the level of its statutory reserves as historically recognized by State law and administrative practice.

5. The burden of the tax must fall with equal impact upon policyholders regardless of the type or size of company in which they are insured.

6. The burden on the savings of life-insurance policyholders should be no heavier than the burden on savers who use other thrift institutions.

7. In fixing the tax level there should be taken into account the unique and high taxes imposed in the various States upon life insurance as compared with other thrift institutions.

8. The tax must not give any company—mutual or stock—an undue competitive advantage by reason of size or type.

9. The formula should be one which does not place a premium upon unsound management decision.

10. In order to encourage the establishment and development of new companies, recognition should be given to the special problems of such companies during their early years.

11. The law should apply only to organizations which in fact, not merely in form, are primarily life-insurance companies.

The aggregate tax burden upon life-insurance savers under the Mills law superimposed on heavy State taxes creates a heavier imposition than that borne by savers through other similar thrift institutions. In spite of that, we believe that the Mills law, substantially in the form in which it originally passed the House, should be made the permanent formula. We believe so for the following reasons:

1. Because we regard it to be the soundest and most thoroughly considered life-insurance tax bill that has been produced in 45 years.

2. Because the method of imposition is a flat tax on investment income, which we believe is the best way to distribute the tax among the different companies, and is the most nearly equitable to the policyholders.

3. Because in its original form it comes closer to giving effect to each of the 11 principles mentioned above than any bill yet produced.

We recognize, however, that the industry has an obligation to explore in an open-minded way any new proposal that may be forthcoming.

We, therefore, recommend the following program:

1. The immediate passage of the Mills law in its present form applicable to the year 1957.

2. That as soon as the Treasury proposal is made public the question of a permanent formula be scheduled for hearing, and both the Treasury proposal, whatever it may be, and the Mills law be considered together.

3. That at the same time the industry be given a full hearing on the provisions relative to pensions and annuities which were deleted by the Senate Finance Committee in 1956.

4. That a definite schedule be worked out whereby full hearings may be had and a permanent law be enacted before the end of the present session.

That is the end of my statement, Mr. Chairman. I thank you very much.

The CHAIRMAN. If it is agreeable with the members of the committee, the Chair would like to recess until 2:30. Mr. Davis will be available for other questions.

(The résumé previously referred to follows:)

CHRONOLOGICAL RÉSUMÉ OF THE HISTORY OF THE 1942, 1950, 1951 AND 1955 LIFE INSURANCE COMPANY TAX ACTS

1942: New formula for taxing life insurance companies adopted after public hearings in the House and Senate. Formula—net investment income less a credit for reserves and other policy liabilities taxed at regular corporate rates. Credit percentage arrived at by applying 3¼ percent to 65 percent of the reserves of each company and the actual reserve interest required to the remaining 35 percent. These amounts of required interest for individual companies thus computed are added to secure an aggregate reserve interest deduction. The ratio of this aggregate sum to the total investment income of all companies is then computed and the result is defined in the law as the Secretary's ratio. The ratio for tax year 1942 was 93 percent.

1943–47: No legislative action—percentage credit for these years under 1942 law as follows: 1943, 91.98 percent; 1944, 92.61 percent; 1945, 95.39 percent; 1946, 95.95 percent; 1947, 100.66 percent.

1947—Late in Summer: When it became apparent no tax would be payable, the life insurance companies communicated with the Treasury and plans were made to study the problem.

1947—October and November: Meeting of companies' representatives and Treasury representatives. The Treasury representatives expressed the view that the whole problem should be reexamined. They were opposed to a permanent formula based on adjustments in the 1942 formula. Stopgap legislation discussed.

1947—December 26 Secretary of the Treasury Snyder issued a press release in which he said: "The present taxing formula applicable to life insurance companies is based on conditions existing at the time of its adoption in 1942. I am confident that the life insurance industry will cooperate with the Treasury and the Congress in developing revised methods of taxation that will be fair and equitable and will not endanger their obligations to their policyholders."

1948—February 19: Meeting with Secretary of Treasury at which the results of Treasury studies were disclosed to life insurance representatives.

1948—February 25 and April 21: Conferences attended by Treasury and industry representatives. Companies submitted a memorandum—outlining adjustments that could be made in the 1942 formula. Technical aspects of problem and stopgap legislation discussed. The Treasury asked for additional information they needed in connection with their studies, which the industry furnished on June 14, 1948.

1949—January and February: Industry spokesman was told by Treasury representative that Treasury was not ready to recommend stopgap legislation. Secretary promulgated a ratio of 102.43 under 1942 law for tax year 1948—In press release he said—"This matter requires urgent attention, and at the first opportunity the Treasury Department will present to the Congress suggestions for taxing life insurance companies."

1949—March 21: Representatives of industry spent a day with Mr. Colin Stam and his staff discussing various tax formulas.

1949—March 28: Chairman of industry tax committee addressed letter to Secretary Snyder proposing a Secretary's ratio of 95 percent be written into the 1942 law.

1949—May 4: Meeting with Treasury. Industry advised Treasury of its objections to the proposal of March 28, 1949.

1949—June 9: Meeting with Treasury—A formula based on average valuation interest rate of industry was discussed.

1949—June 14: Companies submitted to Treasury a draft of an amendment to the 1942 law incorporating average valuation interest rate.

1949—July 21: Conference with Treasury officials—Treasury proposed stopgap legislation, which would be limited to tax years 1948 and 1949 and would tax companies at flat rate of 3 percent on net investment income.

1949—July 29: Chairman company tax committee advised Treasury that industry opposed flat tax proposal as matter of principle, but did not object to the taxes that would be imposed under it.

1949—September 30: Chairman company tax committee wrote to chairman Ways and Means Committee proposing stopgap legislation for 1949 incorporating average valuation interest rate method.

1949—October 10: Secretary of Treasury advised chairman of company tax committee by letter that he would recommend stopgap legislation for tax years 1948 and 1949 based on a 92-percent credit for reserves and other contract liabilities. Chairman Ways and Means Committee introduced House Joint Resolution 371 carrying out Treasury's recommendation.

1949—October 12: Subcommittee appointed by Ways and Means chairman to study life-insurance company tax problem.

1949—November and December: Informal conferences attended by subcommittee and industry representatives.

1950—January 24–26: Without hearings Ways and Means reported House Joint Resolution 371 applicable to tax years 1947–49. Formula amended to base credit on ratio of the total reserve interest requirements of all companies to the total net investment income of all companies. The resulting credit for tax year 1949 was 93.55 percent. House Joint Resolution 371 passed House on January 26.

1950—February 28: Life-insurance witnesses appeared before Ways and Means Committee during general revenue hearings and discussed taxation of life-insurance companies.

1950—March 16 and 20: Hearings before Senate Finance Committee on House Joint Resolution 371. Testimony dealt mainly with retroactive application to tax years 1947 and 1948.

1950—April 10–13: House Joint Resolution 371: Reported favorably by unanimous vote of Finance Committee with amendment restricting application to tax years 1949 and 1950. House Joint Resolution 371 passed by Senate after limited debate on April 13.

1951—June 9: Chairman, life insurance company tax committee advised chairman of Ways and Means that industry opposed extension of 1950 law and recommended 6½-percent flat tax on net investment income.

1951—June 18: Ways and Means reported out House Resolution 4473 the Revenue Act of 1951 extending 1950 act for 1 year.

1951—July 17: At Senate Finance Committee hearing life-insurance witness in behalf of Associations—stated that industry had tested a number of formulas and had concluded that a flat percentage tax on investment income should be adopted—flat tax of 6½ percent recommended in lieu of the 1950 stopgap law, which the industry opposed.

1951—September 18: Senate Finance Committee reported H. R. 4473— favorable with 6½-percent flat tax amendment as proposed by life-insurance associations. This was agreed to in conference on October 18.

1952—May–July: H. R. 7876 enacted extending 6½-percent formula to cover tax year 1952 without hearings.

1953—March: Plan based on total net income approach developed by a member of the staff of the Joint Committee on Internal Revenue Taxation assisted by staff representatives of the Bureau of Internal Revenue, the Treasury Tax Advisory Staff and the Office of Tax Legislative Counsel of the Treasury.

1953—April 20: Industry representatives met with representatives of the Joint Committee on Internal Revenue Taxation and the Treasury Department to discuss the newly developed plan. No final conclusions reached.

1953—July–August: H. R. 6426, Technical Changes Act of 1953 enacted extending 6½-percent formula to apply to taxable year 1953.

1953—November 3: Industry representatives met again with representatives of the Treasury and the Joint Committee on Internal Revenue Taxation. The

history of life-insurance company income-tax legislation as well as the rationale of the flat tax on net investment income were reviewed.

1953—November 23: A letter was directed to the Treasury suggesting further conferences and offering the technical assistance of the life-insurance companies.

1953—December 4: The Treasury replied that it wished to consider some alternative form of taxation and that it might desire consultation toward that end.

1954—January 12: A letter was directed to the Treasury again reviewing the income taxation of life-insurance companies and urging the continuation of a flat tax on net investment income as the form of life insurance company taxation.

1954—February 3: The Treasury replied noting that the President had recommended a continuation of the 6½-percent formula for another year.

1954—March: The House Committee on Ways and Means recommended extension of the 6½-percent formula for 1 year and appointed a special subcommittee to consider the general question of life insurance company taxation.

1954—June 10: A conference was held between life-insurance representatives and the members of the new House subcommittee. The history of the problem was reviewed. The subcommittee set July 10 as a target date for receiving any suggestions of the life-insurance business with respect to a permanent formula.

1954—June 18: The Senate Finance Committee favorably reported H. R. 8300 with section extending 6½ percent formula.

1954—July 20: A new suggested method of taxation was presented by the industry to the House subcommittee. The subcommittee received the proposal and indicated that it would be considered at a later date during public hearings.

1954—August 16: H. R. 8300 extending 6½ percent formula signed into law by President as Public Law 591.

1954—November: The special House subcommittee announced hearings on life-insurance company taxation to begin December 13 and published a preliminary statement of facts and issues with respect to the Federal taxation of life-insurance companies. This comprehensive staff study formed the basis for the announced hearings.

1954—December 13: Three days of hearings held by a special House subcommittee and extensive testimony furnished by the life-insurance companies. The flat tax method of taxation was supported by industry witnesses.

1955—January to June: In January, the special subcommittee made a lengthy report to the full Committee on Ways and Means, including a number of recommendations later incorporated into a specific bill. Legislative decisions in preparation of bill made by full committee in executive sessions during spring.

1955—July 7 to 18: H. R. 7201, the Mills bill, was introduced as legislation to provide a permanent formula for taxing the life-insurance companies, but was introduced on a 1-year trial basis in deference to a Treasury Department request and passed the House on July 18.

1955—July 25: Hearings were held on H. R. 7201 by the Senate Finance Committee. Following these hearings, the committee failed to act on this bill and it was carried over to the next session.

1955—August 30: Internal Revenue Commissioner issued a statement that he had been advised by the Senate Finance Committee chairman that it was not the committee's intention to require the life-insurance companies to compute their 1955 tax under the 1942 law and that it was the committee's intention to work out a law before March 15, 1956.

1955—December 5: The Secretary of the Treasury requested the life-insurance companies to provide actuarial experts to give technical assistance and advice. Five actuaries were placed at the Department's disposal. Five meetings ensued between January and June 1956.

1956—February–March: The Senate Finance Committee approved H. R. 7201 with certain amendments on a 1-year basis for the taxable year 1955, which became law on March 13. The committee in its report on H. R. 7201 stated, "The committee expects that additional legislation will be initiated in the House during this year relating to the taxing of life-insurance companies for the future." The committee expected the Treasury to propose a permanent formula.

1956—June–July: H. R. 11995 extending the 1955 formula to the taxable year 1956 was enacted.

1957—June: When it appeared that the Treasury's proposal would not be submitted in time to permit consideration before the end of the session, life-insurance representatives conferred with Congressman Wilbur Mills, chairman of the subcommittee having jurisdiction over the company-tax problem and

recommended that a bill be introduced to extend the Mills law to cover tax year 1957. Mr. Mills advised that the Treasury's attitude on such an extension should be determined.

1957—July: At a conference between the Secretary of the Treasury and life-insurance representatives extension of the Mills law to cover the taxable year 1957 was urged, but the Secretary who had just taken office advised that his recommendation could not be made without further study. He indicated that he would make his position known before the beginning of the next session. When advised of the Secretary's attitude, the chairman of the Ways and Means Committee decided to defer action until the Treasury's recommendation was received.

1957—November 20: A letter was written by the life-insurance representatives to the Treasury again urging it to recommend extension of the Mills law. A comprehensive memorandum was submitted with the letter dealing with the taxation of life insurance generally.

1958—January 10: The Treasury addressed correspondence to the Ways and Means Committee and the Senate Finance Committee agreeing to an extension of the Mills law to cover 1957. The correspondence expressed the hope that a permanent method of taxation which would be fair and equitable could be worked out later on.

1958—January: H. R. 10021 introduced to extend the Mills law for an additional year, was favorably reported by the Committee on Ways and Means on January 23 and passed the House on January 30.

1958—February: H. R. 10021 was considered by the Senate Finance Committee in executive session on February 21 and after discussion hearings were set for March 5.

(Whereupon, the committee took a recess to reconvene at 2:30 p. m. the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.

The next witness is Mr. Charles A. Taylor, president, the Life Insurance Company of Virginia, speaking for the Life Insurance Association of America, American Life Convention, and Life Insurers Conference.

Please proceed.

Senator ANDERSON. Mr. Chairman, we were going to have an opportunity to interrogate the previous witness.

STATEMENT OF CHARLES A. TAYLOR, PRESIDENT, THE LIFE INSURANCE COMPANY OF VIRGINIA

Mr. TAYLOR. Thank you, Senator and gentlemen.

My name is Charles A. Taylor, president of the Life Insurance Company of Virginia at Richmond, Va.

I am a fellow of the Society of Actuaries.

As a representative of a stock life insurance company, I would like the privilege of emphasizing some of the things Mr. Davis has said and adding a few comments from the stock company point of view.

There are, of course, many differences between the operations of stock and mutual companies, but these are more of detail than of principle and there are many more likenesses than there are differences. Probably the most important likeness is that we both sell level-premium life-insurance contracts. That is so say, we both issue long-term contracts—at premiums fixed for the duration of the contract at the time of issue—against the risk of death, which risk is an increasing one as age increases. It is this charging of a level premium against an increasing risk that brings about the necessity for our level-premium reserve system, which in turn brings about many of the peculiarities

of life insurance—such as cash surrender values—and differentiates it from other forms of insurance.

Under this reserve system both mutual and stock companies are under compulsion to set aside and invest out of early premiums sums to be drawn upon in the later years when the costs of paying claims exceed the premiums.

It seems to me unfortunate that the word "reserve" is so firmly attached to these sums, because they are not "reserves" as that term is used in other business. They are much closer kin to the deposit liabilities of a bank, for example, than they are to a bank's "reserves for losses."

Another way of looking at level-premium life insurance is this: Life insurance being a means of sharing risks by redistributing capital in accordance with the order in which deaths take place, each premium is a deposit of capital, discounted for the interest expected to be earned, and therefore, from the economic point of view, as well as the policyholder's point of view, the only income is the investment income. From the point of view of the stockholders of a life-insurance company, there can be other income. By no stretch of the imagination, however, are the dollars added to surplus of a stock life-insurance company necessarily income to the stockholder. They may be and then, again, they may not, because of the long-term nature of our contracts. Only time will tell. My point, however, is that stock companies do have income, mostly investment income, and should pay and want to pay their fair share of Federal income taxes.

One of the major differences between stock and mutual companies is the different way in which they generally fix their premiums. The mutual companies, having no capital stock and, often, limitations upon the amount of surplus they can accumulate, generally fix their premiums on the conservative side—considerably higher than nonparticipating premiums—and contemplate returning to policyholders, in the form of policy dividends, what is not needed. The stock companies generally fix their premiums at a lower level, guarantee them for the duration of the contract, and do not pay dividends.

We think these two ways of conducting the life-insurance business should have the right to compete for public acceptance and that it is in the public interest to do so.

This, in itself, seems to me reason enough for very similar treatment of the two types under the Federal income-tax laws, but there seem to me to be other reasons, too. I have already said that our policy "reserves" could be better described as "policy contract liabilities," but, if the full title were to be given, it would be something like: "An actuarial estimate of the money needed, in excess of premiums to be received in the future, to pay future death and other policy-contract claims, assuming money will earn a specified rate of interest; assuming death rates will be in accordance with the adopted mortality tables; and assuming, further, that expenses will be met exactly from future premiums.

If such a title, which I believe accurately describes our American policy-valuation system, leaves you with a feeling that surplus funds may be needed to supplement the reserves, that is the point I am trying to make. We are confident we are using safe and conservative bases. And the State insurance departments are charged with the

responsibility of seeing that we meet certain statutory minimums as well as with the responsibility of seeking new legislation if there is evidence that conditions have changed. But there cannot help but be uncertainty. This leads me to another point—that much of what we call surplus in the life-insurance business is much closer to what is usually termed a reserve in other business than to true surplus. Some of the reasons are:

1. The possibility that, under changed conditions, prudence may require a program of reserve strengthening.

2. Recognition of the fact that the contingent liabilities of a life-insurance company are enormous. Our life insurance in force can be looked upon as a contingent liability, and is generally many times greater than our total assets and very many times greater than our surplus and other safety-margin funds.

3. Recognition of the fact that big, temporary fluctuations can occur in our mortality rates and that conservative policy reserves make little provision for such catastrophic calls on our emergency resources.

If, for example, the Asiatic flu epidemic of last year had been a genuine killer as the Spanish flu was thirty-odd years ago, there would be no need for arguing that life-insurance companies need large surplus funds. The need would be painfully apparent to all.

4. As long-term investors, we must assume that we will have both periods of great fluctuations in the values of our assets, and periods of bad business in which we will have to suffer substantial asset losses.

5. Recognition of the fact that expenses may well rise, under inflationary pressures, beyond the ability of future premiums on old business to absorb them.

In the case of stock companies, these points are more pressing than in the case of the mutuals, who have fairly large margins in their premiums to help meet them. And the fact that it is necessary for stock companies to accumulate more surplus funds than mutual companies is recognized in our State regulatory system by excluding stock companies from limitations upon the amount of surplus accumulation.

The burden of taxation ultimately falls upon the policyholder. Taxes find their way into the pricing structure of all business, and life insurance is no exception. The premiums the public will pay for policies in the future will probably reflect any increased taxload. Of course, stock companies cannot increase premiums on policies already on the books, but the interests of those old policyholders will be affected adversely by taxes that are too high.

For example, reserve-strengthening programs and voluntary liberalizations of old contracts may disappear. But, more important, their insurance companies may be forced to lessen their security by skating on the thin ice of narrow safety margins. To me, the very fact that stock companies cannot reflect increased taxes on their premiums for old policies, while mutual companies can, in effect, do so by reducing their dividends is a pressing reason why Congress should make no change in tax laws which would bring about any such situation, thus endangering the solvency of the company.

We believe that the burden of taxation, under the Mills bill and under the State premium-tax laws, is already heavy. We believe it

unfair to judge the taxload of life insurance by looking at Federal income taxes alone. We are supervised and regulated by the States, and much more heavily taxed by the States than other business. Congress recognized these facts in Public Law 15 of 1945 and gave its blessing not only to State regulation but to State taxation, as well.

We believe that the Mills law, which was originally designed as permanent legislation, is the most carefully considered and most equitable of any proposed in recent years, and we share the view that the 1942 and 1950 laws are unsound and should not be reinstated. May I interpolate there that I know, too, that the 1942 law is now in effect.

They are unsound because of the vagaries of the taxes produced. Recently, I discussed the 1942 law with a seasoned member of the House Ways and Means Committee, who commented, when the total tax variation under that law was shown to him: "If the Government's income under that law has varied that much, it is, obviously, an unsound law."

Under the 1942 and the 1950 laws, the tax burden of small companies will be increased to a greater extent than for the larger ones. That was pointed out this morning by Mr. Smith. For example, under the 1942 law, a company with investment income of $100 million, the Federal income tax would be increased 49.2 percent; but a small company, one with an investment income of $500,000, would have its tax increased 94.8 percent.

We do not believe the 1942 or 1950 laws, being based upon the theory that a proper measure of taxable income is the excess of net investment income earned over the "interest required to maintain reserves," are sound.

I have labored over the necessity, in the life insurance business, for conservatism in setting up our policy reserves and of our safety margins beyond the policy reserves. The 1950 law, and to a lesser extent, the 1942 law places a premium on holding smaller reserves and margins. This, I am sure, is not in the public interest.

Also from the point of view of a stock company, the policy reserve interest rate is, both for reasons of practicability and reasons of conservatism, frequently considerably lower than the rate used in computing the premiums. It is entirely possible for anticipated gains from interest to have been reflected in the premiums policyholders are paying and a real injustice can be done stock companies and nonparticipating policyholders if the free interest theory should be used as a measure of the tax.

We urge that the Mills law be enacted for another year and that the Treasury be urged to bring its proposal for changes in plenty of time during this year so that the subject can be explored and debated in the open by all who are interested and so that enough time is available for mature consideration by both Houses of Congress.

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

Are there any questions?

Senator Anderson.

Senator ANDERSON. You say here that under the 1942 and 1950 law, the tax burdens of the smaller companies will be increased to a greater extent than the larger ones.

Mr. TAYLOR. Yes, sir, that was mentioned this morning by Mr. Smith of the Treasury.

Senator ANDERSON. It was? I thought I read Mr. Smith's table before on page 5 to show the companies above a million net investment income, it would take .7507 to meet their policy interest retirements, and the companies with less would take .7139.

Since the breaking point, I believe, is about 77 under the 1942 law, how is the punishment greater to the smaller ones there?

Mr. TAYLOR. Actually, the Mills law makes a specific allowance for the smaller companies. There is a reserve deduction of 85 percent for the larger companies and 87½ percent for the smaller ones.

Senator ANDERSON. But the figures that the Treasury gave do not seem to work out for the rest, do they?

Mr. TAYLOR. I was looking at the wrong page. You mean the group from 1 to 111,000.

Senator ANDERSON. No, I am talking about page 5.

Mr. TAYLOR. I see. This page 5 has a calculation of the interest required rather than of the actual tax.

Senator ANDERSON. Yes.

Mr. TAYLOR. We made some tests under both laws and I am sure my statement that the smaller companies get a greater increase than the larger is correct.

Senator ANDERSON. That is the point we have been trying to get to here since the first meeting.

Have you some figures to show it company by company?

Mr. TAYLOR. No, sir, I did not bring any such figures.

Senator ANDERSON. Wouldn't that be the best evidence?

Mr. TAYLOR. There will be some witnesses this afternoon who might throw some light on that subject, but I am sure we would be glad to give you any figures for the record you would like to have, sir.

Senator ANDERSON. Is your company entered in the District of Columbia?

Mr. TAYLOR. Yes, sir.

Senator ANDERSON. Have you filed your statement in the District of Columbia?

Mr. TAYLOR. Yes, sir.

Senator ANDERSON. What did you do when you got down to section 15, taxes, license or fees due or accrual including so much United States Federal income tax, exhibit 6, line 8. How do you figure that?

Mr. TAYLOR. We figured it, sir, on the basis of the 1942 law.

Senator ANDERSON. That was on the 1942 law?

Mr. TAYLOR. Yes.

Senator ANDERSON. Therefore, you think most of the companies have expected to have the 1942 law——

Mr. TAYLOR. A good many statements have come over my desk in recent days, and as far as I have seen so far, we are the only company who has treated the item that way.

Senator ANDERSON. I congratulate you on it because an official has to make a sworn statement, that the statement is the truth, and if you made that statement including the tax figures on the basis of the 1942 law, it was a very accurate statement and you are to be commended for it.

A company which has estimated its provisions under the Mills bill so-called would be in a very unusual position if the bill did not get through, wouldn't it, because it would have incorrectly stated the

profit and loss situation of his company as of the present law as of this date.

Mr. TAYLOR. That could be, unless other provision were made in the statement under some other item, I agree with you, sir. I would hate to be in their position.

Senator ANDERSON. I would too because I do not find any provision in the law that says you need not show the amount of the Federal income taxes due under the law.

If your company used the 1942 law, it was eminently correct and entitled to praise because that is what the law is.

Now if the Congress subsequently deals differently, that is a different story. The statement was made that most of the companies had set it up on the other basis.

Mr. TAYLOR. I would hate to have that go in the record, because I really have only casually looked at a few statements.

Senator ANDERSON. I know you said it, but I have a memorandum from some of the insurance companies making that statement.

Did you know an A. J. McCandless, chairman of the Joint Committee on Federal Income Taxation of Life Insurance Companies?

Mr. TAYLOR. Yes, sir, I know him.

Senator ANDERSON. He appeared before the United States Senate Committee on Finance. I am looking at page 40 of the testimony on March 16 to 29, 1950, with reference to the 1950 law, and Senator Millikin asked him the question:

Senator MILLIKIN. Would the life insurance companies object if this same formula were made effective for the future?

Mr. MCCANDLESS. I think the life insurance companies would welcome this if it was made effective for the future. One of the resolutions passed by these organizations at a meeting in Chicago was to the effect that the industry favored this legislation for the year 1950 and all years thereafter unless changed by Congress. We look at it as at least containing the nucleus of a permanent solution to this question. There might be slight modification which we would like to make in the future, but we think it is in the direction of a permanent solution of this question of taxing life insurance companies, because it automatically adjusts itself to changing conditions in the life insurance business with reference to the rates of interest earned and the valuation rate of interest used by the companies.

Has there been any change in the attitude of the life insurance companies since the time that testimony was given?

Mr. TAYLOR. Quite possibly, sir. I was not a member of the Taxation Committee. Conditions have certainly changed very materially. The level of taxes has gone up very materially, and I do not know what Mr. McCandless would say if he were alive. Unfortunately he is not.

Senator ANDERSON. But at that time he was the spokesman for the Joint Committee on Federal Income Taxation of Life Insurance Companies appearing on behalf of Life Insurance Association of America and the American Life Convention.

Mr. TAYLOR. Yes, sir.

Senator ANDERSON. It was his conviction that the 1950 law was desirable and suitable for permanent legislation.

Mr. TAYLOR. Yes, sir.

Senator ANDERSON. After a very short time it changes so maybe the testimony that is now being given will be subject to some alterations as we go along.

Mr. TAYLOR. It is quite possible, sir, that minds do change over periods of many years.

I cannot promise you that mine will not over a period of years. As I see it today is the way I testified today.

Senator ANDERSON. Mr. Adams was present in 1951, I believe, Mr. Adams. Did you testify anything about the 1950 law before the House?

Mr. ADAMS. I did, sir. I did testify.

Senator ANDERSON. Do you recall what you testified at that time?

Mr. ADAMS. I testified that 1 year's experience with the 1950 law had shown that it would give us such a steeply accelerated tax that it would be heavier than the life-insurance business could well bear.

In addition thereto that because the 1950 act did not levy the tax on the individual experience of the companies but taxed 1 company on another company's experience, which principle is implicit in the 1950 law (somebody making less and someone more and all taxed the same), that the law was repugnant to the Treasury, had its severe critics in the industry, was objected to by members of the Senate Finance Committee. So after 1 year's trial for all of those reasons, including the fact that with changed conditions the taxes skyrocketed by rate, the effective rate, under the 1950 law mind you, in 1950 was 6¼ percent, it is now up to 15.2 on the same formula. Therefore we persuaded the Finance Committee at that time that the 1950 law was not sound in spite of what we had said the year before.

Now if you will excuse me——

Senator ANDERSON. Let me read ou what you said at page 1176, Claris Adams, president of the Ohio Life Insurance Co., Chairman of the Joint Committee on Federal Income Taxation, Life Insurance Companies, and American Life Convention of Chicago and the Life Insurance Association of America, New York, and so forth.

I am not reading everything but I hope I am not leaving something out that is essential:

> I appear under direction from this committee upon the authority of the governing boards of both these bodies to state it is the unanimous opinion of our committee at this time that the so-called stopgap legislation which became law in 1950 but expired by its own terms on December 31 should be extended for another year. Later we may have some recommendations for permanent legislation. However, we have no alternative suggestion now which we believe would be an improvement on the act of 1950.

Mr. ADAMS. That, sir, was testimony in the House of Representatives?

Senator ANDERSON. Is there a difference between your testimony in the two bodies?

Mr. ADAMS. There is, and I will tell you why. That was in May or April. I said we were trying to find a more simple tax because Senator George, Senator Millikin and I think Senator Byrd were very doubtful about this averaging process that was implicit in the 1950 act. So as I said to the Ways and Means Committee, Chairman Doughton, that we were trying to get something more simple that would be more satisfactory. Between April and the time we were over here in June we did so. And if you will follow my testimony in the Senate, I said, I am an old Indianian, but I am not like my friend Senator Watson who when he was talking on one side one day and another a year later, said "sufficient unto the day is the consistency thereof." I was not in that situation because in the councils of the business I had always been for this 6½ percent tax.

The majority was the other way and they were just catching up with me and it just took them 1 year to find out I had been right all the time.

Senator ANDERSON. Then why did you recommend the extension of the 1950 law for the year 1951?

Mr. ADAMS. In the spring because at that time we had no better law. Between April and the time I appeared herein June, we constructed a better law. We presented it for the reasons I have stated. It received a unanimous vote of the Finance Committee.

In those days I was young and had a straight mouth and maybe I was more persuasive, but at least it was approved unanimously because the Committee preferred a simple, direct, tax on each company's individual basis instead, and furthermore it was seen that there was a built-in accelleration tax clause which was going to become too heavy a load for a great social institution like life insurance.

This was not just because interest was going down, but the companies had to put up greater reserves which they had retained from policyholders for that purpose, and that resulted in an increasing tax margin and made vagaries such that everybody agreed at that time that after 1 year it was very wrong. We were wrong and the Senate Finance Commitee had been wrong, and we both corrected the error 1 year later.

Senator ANDERSON. What is it that constitutes a good bill? Upon the testimony here this 1950 law would produce $536 million in 1957 and the Mills bill that is being proposed will raise $291 million. Is that the final test of the law?

Mr. ADAMS. No; that is not the final test.

Senator ANDERSON. What is the final test?

Mr. ADAMS. In my opinion, it is what burden it will lay on Henry Jones, policyholder, and Sara Smith, widow. They are the only people that can pay 70 percent of this tax because they are policyholders in mutual life-insurance companies. The Mills law taxes them more heavily than the law does in Canada, or in Great Britain, and more heavily than if they put their money in savings banks. How in the world it can be considered by gentlemen of your distinction that life insurance is undertaxed is just beyond me.

Senator ANDERSON. When you get down to protecting widows, of course, you are on sound ground.

Mr. ADAMS. Because we represent 100 million of policyholders and many million widows.

Senator ANDERSON. And some stockholders are in stock life-insurance companies.

Mr. ADAMS. That is right.

Senator ANDERSON. Are they better off or worse off under the Mills bill than they would be under the 1942 law?

Mr. ADAMS. Every company, stock or mutual, is worse off—the policyholder, the widow, the stockholder, are all better off under the Mills bill, than the 1942 law. However, 70 percent of the tax is paid not by the stockholders under the Mills bill or under the 1942 law or the 1950 law, but by the policyholders, Henry Jones on Main Street and Sara Smith, widow, who is living on the proceeds of life-insurance policies.

They are the ones that pay it, and I think there is a great social question involved.

Now if you want to make a distinction, we are going to have a new plan, we are going to have general hearings, but I just would like to say this. I am here on my feet because you asked me to, Senator.

Senator ANDERSON. Yes; I just wanted to get to this testimony.

Mr. ADAMS. I did not want to make a speech but I want to say this one thing. There has been something said here, that you might take care of small companies by a simple amendment here, that the same provision could be applied in the 1942 law.

As you know the 15th of March is around the corner. It will be difficult to get this bill passed in the Senate, and back to the House in time and so the choice is between the Mills bill as it is or the 1942 law as it is. There certainly is not time to change it here, send it back to the House and have it on the President's desk by the 15th of March.

And that is not our fault. The bill was over here the 1st of February but we got behind quite a discussion in this committee on the debt limit as you know, and therefore it was delayed.

Senator WILLIAMS. Speaking of the debt limit, you said what we do on this bill affects Henry Jones on Main Street. If we pass the Mills proposal, which in effect gives this retroactive tax reduction of 120 some million, the same Henry Jones is going to be taxed otherwise to make up that $120 million for the Treasury; isn't he?

Mr. ADAMS. That 120 million was not in the budget as it came up.

Senator WILLIAMS. But the Treasury is going to need it.

Mr. ADAMS. You would know that.

Senator WILLIAMS. I say it is the same Henry Jones that is going to pay the tax regardless of which way we do it; is that not true?

Mr. ADAMS. I would not think so because income taxes are graduated by income.

We have 50 percent at least more policyholders than we have income taxpayers in the United States. Just think of that, and the average policyholder is insured for one and a half times his family income, and on that and social security his dependents are going to have to eke out an existence.

It is a special kind of savings for one of the most important problems of human life.

Senator WILLIAMS. I am not questioning that but still the Henry Jones on Main Street with the low income bracket pays most of the taxes of this country.

Mr. ADAMS. We have millions of policyholders below that bracket that you would be taxing under the 1942 law.

The CHAIRMAN. Senator Anderson.

Senator ANDERSON. I saw in the New York Times on Sunday a sketch on Prudential Life in which it talked a good deal about the vigor and strength of the president of that company, and told how he threatened to move out of New Jersey if they did not reduce the State tax.

The company was one of New Jersey's biggest taxpayers, especially since it was forced to pay $5.50 of each hundred of surplus in its treasury.

This company, executives complained, were put in an unfair competitive position with its neighbors across the river in New York.

Apparently that tax had been in existence for a long while. Did it keep the Prudential from growing?

Mr. ADAMS. I am not from Prudential, but I will tell you what Prudential has done. It has built home office buildings now in Jack-

sonville, Fla., in Minneapolis, in Chicago, Ill., Los Angeles, and Houston, Tex.

Whether that had anything to do with their local tax I do not know but they decentralized.

Senator ANDERSON. Would that have changed its tax structure as a New Jersey corporation?

Mr. ADAMS. That I do not know. There are Prudential men here. But I will tell you this. It is one of the biggest financial institutions in the world but it is big because it owes so many people so much money. It has 30 million policyholders with about an average of $600 savings on deposit with the company.

Now, the fact a person is with a small company, is not the question. It is the same with policyholders that are in Prudential. They do industrial business.

Mr. Menagh back there is vice president of Prudential. If you want to interrupt this testimony, perhaps he can tell you. I cannot. That is a municipal tax in Newark, N. J., that they are talking about.

Senator ANDERSON. That was a very heavy tax, and when the Federal Government—and I saw the figure it was a substantial sum of money, but I wonder if that meant that all the little people from down all the streets were going to have such a terrible time with dividends because of this change in the law.

What did they do when the 1950 law was in effect? Did they change their dividend rates?

Mr. TAYLOR. I could not answer that, if you are directing the question to me. My guess is that when the 1950 law was in effect, their interest returns were considerably lower than they are now.

Senator ANDERSON. And the amount collected was relatively small.

Mr. ADAMS. If you will pardon me, one more sentence, Senator. It is a fact historically and I can answer it because I have been here several times, that the 1950 law did invade the reserve requirements of a number of companies, and that is one reason it was changed.

And when the 1951 law came in, there was a special relief provision under which companies that made less than their interest requirements would pay a lesser tax than the basic tax on other companies.

Mr. Stam remembers that very well. The 1950 law did invade the reserve requirements, and there is a gentleman to testify next who went through that experience in his own company. He will explain specifically how it applied to an individual mutual company.

Senator GORE. Will Senator Anderson yield?

Senator ANDERSON. Yes.

Senator GORE. I have here a photostatic copy of a letter from Mr. Congleton, who is general attorney for Prudential Life. His letter states that under present law the tax liability of Prudential Life would be $57 million accruing March 15. Under the Mills so-called stopgap bill, the liability would be $38,500,000.

I thought the Senator would be interested in that information.

Senator ANDERSON. Yes, and under the 1950 formula it would have been $75 million plus.

Yet the association in 1950 said this would be good, permanent legislation.

Mr. TAYLOR. I am sorry they did if they did. It does not look that way now.

The CHAIRMAN. Are there any further questions?

Senator GORE. Mr. Taylor, I am new with this committee.

Mr. TAYLOR. So am I.

Senator GORE. Then we will suffer together. One of the experienced members of this committee said the other day that the best way for one to rid himself of ignorance was to expose it, and I have exposed my ignorance on this subject several times already, and if I expose it further by asking you questions which are not proper, then you will kindly say so.

Mr. TAYLOR. I will answer them if I can.

Senator GORE. I assume that the financial statement of your company is published?

Mr. TAYLOR. Yes, sir.

Senator GORE. I thought that was right. I should know whether or not you are considered a large or a small or an intermediate-sized company.

Mr. TAYLOR. Probably intermediate. We have assets of $426 million, and I think we would range probably 30th in size. These are companies 25 or 30 times bigger than that. We are a medium-sized company.

Senator GORE. Thank you, sir. In your financial statement of calendar year 1957 what do you show under the item net gain from operations before dividends to policyholders and excluding capital gains and losses? Again, I want to be sure this is information that is available to all policyholders.

Mr. TAYLOR. This is public information and I have no objection to stating it.

Net gain from operations before dividends to policyholders is the question you asked?

Senator GORE. Yes.

Mr. TAYLOR. $3,649,427.54.

Senator GORE. Is that also excluding capital gains and losses?

Mr. TAYLOR. Yes, sir. That is before capital gains and losses.

Senator GORE. That was $3 million what?

Mr. TAYLOR. $3,649,000.

Senator GORE. What do you show under net gains to surplus account?

Mr. TAYLOR. I will have to subtract two figures here. It is approximately $2 million, $2,014,000 net gain in surplus.

Senator GORE. What have you calculated your tax liability to be?

Mr. TAYLOR. On the 1942 act the liability is not the whole year's tax because part had been paid.

Senator GORE. Including the part that has been paid, what would be your tax?

Mr. TAYLOR. The tax for the year under the 1942 act was $1,694,695.

Senator GORE. What would it be under the Mills bill?

Mr. TAYLOR. $527,000 less, $1,168,000.

Senator GORE. Does the present law impose upon your company an unbearable burden of taxation?

Mr. TAYLOR. No, sir, I cannot come here begging for relief, that we have been ruined by the imposition of that tax. I am here making a plea not to extend any further than you have to a law which I believe contains unsound principles, and because I believe the equities of the situation, the way this 1942 act is added on to the Mills bill by

the Treasury as sort of a safety net in case the Mills bill is found unworkable, and pending new proposals which they are preparing, I believe the equities of the situation are such that we have a right to ask for, if you choose to call it, sir, retroactive tax relief.

Senator GORE. You have every right to ask it, Mr. Taylor, and I am trying to get enough information to determine my own position.

Was your net gain to surplus calculated after the calculation of your taxes under present law or was it calculated on the basis of the possible enactment of the Mills bill?

Mr. TAYLOR. It was calculated on the basis of the 1942 law, not on the basis of the Mills bill.

Senator GORE. Then on the basis of the 1942 law——

Mr. TAYLOR. Yes.

Senator GORE. You have had a net gain——

Mr. TAYLOR. In surplus.

Senator GORE (continuing). In surplus of in excess of 2 millions.

Mr. TAYLOR. Yes, sir. I hope you listened to me when I read my statement.

Senator GORE. I did.

Mr. TAYLOR. That all we put into surplus may not turn out to be surplus.

Senator GORE. I understood.

Mr. TAYLOR. We had increases in these contingency liabilities. We had increases on our real liability. We needed increases in our safety margin.

Senator GORE. And conversely it might turn out, who can tell, that you have underestimated your liabilities.

Mr. TAYLOR. It is entirely possible.

Senator GORE. And the trend in vital statistics has been in your favor rather than against you.

Mr. TAYLOR. In recent years very definitely, although there may have been a slight turn in 1957.

All the figures are not in, but I suspect mortality rose a little in 1957.

Over the last 50 years there is no question about the fact mortality has declined. That has played in our favor, and very fortunately so, because there was what might have been a calamitous decline in the interest rate during much of that period, and the gain from mortality was to quite a large extent offset by the decline in interest earnings.

Also, we have been under pressure expensewise as prices of everything have gone up, we have been under pressure to keep our expenses under control like everybody else.

Senator GORE. I think, Mr. Taylor, you have been a very forthright and a very helpful witness.

Senator ANDERSON. I want to say the same thing, Mr. Chairman. I think this is very fine testimony.

The CHAIRMAN. The next witness is Mr. John A. Lloyd, president, the Union Central Life Insurance Co.

Mr. DAVIS. Mr. Chairman, there is one matter I would like to read into the record.

In view of the statement that was made this morning——

The CHAIRMAN. Mr. Davis has requested permission to make an insertion in the record.

Mr. DAVIS. In view of the statement I made this morning that it was my understanding that the Secretary of the Treasury had stated

to the Ways and Means Committee that he was in favor of the enactment of this stopgap legislation, I would like to say that I hold in my hands the galley proof of the record of that meeting and there is one paragraph I would like to read.

> We have already advised the committee that the Treasury is agreeable to the application of the stopgap legislation concerning taxes to be applied against the income of life-insurance companies for the calendar year 1957. We are giving a great deal of thought to the development of a fair and equitable system of taxation that can be permanently applied, and will be working cooperatively with your staff in the development of concrete proposals which we hope to submit to you in the near future.

I have always thought that the word "agreed" meant that he approved of the legislation. That is why I made the statement.

Senator ANDERSON. That is why I tried to check it, because there was no reason for him to send that kind of a report to us if he took a different position in the House.

I think he did just what he said there. He is not going to object to it. He is agreeable to doing it if we want to but he does not favor it, does he? Do you find that he does?

Mr. DAVIS. I believe that he does, yes, sir.

Senator ANDERSON. He takes awful pains when he writes this letter to make sure that he says that he does not have any objection to it?

Mr. DAVIS. Whatever the Secretary meant, it is perfectly obvious from the record on the floor of the House that the chairman of the Ways and Means Committee so construed it as it reads in this record, because when he made the report on the floor of the House which was quoted this morning by the chairman of this committee, it is perfectly obvious that he recommends it.

What he was trying to do, I am convinced that he does not want to go on record that the Secretary of the Treasury is in favor of that bill for any permanent legislation.

I think that is where all this difficulty comes as to what is meant there.

Senator GORE. You would agree that since there is doubt as to whether the Secretary of the Treasury recommends enactment of the Mills bill, that there is ample opportunity for him to send another letter up today or tomorrow to make his position clear.

Mr. DAVIS. I would think so, if he is in town.

Is that all, Mr. Chairman?

The CHAIRMAN. Thank you, Mr. Davis.

Mr. John A. Lloyd, president of the Union Central Life Insurance Company.

STATEMENT OF JOHN A. LLOYD, PRESIDENT, THE UNION CENTRAL LIFE INSURANCE CO., CINCINNATI, OHIO

Mr. LLOYD. Mr. Chairman, and members of the committee, my name is John A. Lloyd. I am president of the Union Central Life Insurance Company of Cincinnati, a mutual company organized in 1867, and owned by our policyholders and operated for their sole benefit.

I am 1 of what I believe will be 6 witnesses who will come here and testify to the specific inequities of the 1942 law and the 1950 law in connection with the matters that are presently being heard.

Our company has $2,488,855,006 of insurance in force and resources of $763,959,026.28. We have 564,996 policies and certificates in force and issue ordinary life and group life-insurance contracts only. Our company is typical of many fine, strong life-insurance companies operating in the United States.

On our policies and contracts we maintain, as required by law and contract, policy and contract reserves totaling $700,486,187.35.

When we speak of policy reserves we mean that we accumulate for each policy the net deposits made by the policyholders at a guaranteed rate of interest. It is these funds and the interest earnings thereon which are the cash, surrender, and loan values of the policies and which, as they build up over the years, create the money with which to pay out the policies at maturity. They are the property of the policyholders and constitute demand deposits which may be withdrawn by the policyholders at any time with guaranteed interest. These guaranteed interest earnings must be added to the reserve account whether or not earned by the company's investments and constitute a primary, major, and inviolate obligation of every company.

By the demand of these policy and contract reserves we are required to earn:

3½ percent on $226,957,015.42
3 percent on $340,204,515.78
2¾ percent on $1,632,373.00
2½ percent on $34,553,206.66
2¼ percent on $83,687,225.00

The total dollars of interest which we were required to earn in 1957 was $21,286,464.69.

Our taxable net investment income in 1957 was $23,602,369.46. Deducting $21,286,464.69, the interest requried to be earned, our company showed a gain of $2,315,904.77 before Federal income taxes. Our taxes under the Mills bill are $1,822,484.83. This leaves us $493,419.95, after taxes on a before-taxes figure of $2,315,904.77.

The effective rate of taxation of the Mills bill, therefore, is 79.83 percent, so far as our company is concerned.

If the 1942 act were to be applied, our taxes would be $2,736,343.19, and would produce an investment income deficit of $420,438.42 in our reserve requirements and if the 1950 law were reenacted, our taxes would be $3,600,966.30, producing a $1,285,061.53 deficit in the interest we are required to earn.

Leaving aside every consideration except that of simple arithmetic, I submit to you that a life-insurance company not only has a right but a contract obligation to earn the interest required to pay out the policies and contracts it issues and that any proposed tax law which prevents it from so doing should not be enacted.

Yet either the 1942 law or the 1950 law would prevent our economy and many others from earning their contractually required interest.

We, therefore, present the above facts to your committee, urging that the Mills bill be reenacted for 1 year to apply to 1957 business; that the proposal to enact the 1950 basis into law affecting future years be abandoned; and that whatever plan of taxation the Treasury brings forward under its agreement with your committee to produce such a proposal be given consideration at the earliest possible moment after it is announced.

Thank you very much.

The CHAIRMAN. Are there any questions?

Senator ANDERSON. What do you include in taxable net investment income? Is that all your investment income?

Mr. LLOYD. That is our investment income less the investment expenses allowed under the statute.

Senator ANDERSON. Do you know about how much that is?

Mr. LLOYD. I can tell you what it is, Senator. Offhand, I cannot tell you how much it is. It is the expenses of putting investments on the books and maintaining them there.

For example, we charge ourselves rent for our own home-office building for the space we occupy in it. The part that is deductible for income-tax purposes is only that part which applies to our mortgage loan department and our bond department. When we charge a salary, only the salaries of people working on investments are charged.

When we take my own salary, for instance, it is allocated on a basis of how much of my time I put in on the investment end of the business. The items which we may deduct are exceedingly restricted in the statute.

I am sorry; I cannot at the moment give you the exact figure.

Senator ANDERSON. Do you have a figure for operating income, or anything comparable to that?

Mr. LLOYD. The nearest, Senator Anderson, that I can come to giving you that is to give to you what happened in the overall results of our company operations for last year.

If that would be interesting to you, I would be glad to give it to you. After all of our operations last year, the payment of claims, death claims, and putting up of reserves and the taking in of premium deposits and the making of investments and everything, after the entire year's operation we made what we refer to as a gross surplus increase of $12,201,000.

Now what happened to that money?

We paid dividends to policyholders in the amount of $7,127,000. We strengthened reserves on life-insurance contracts which were going into the annuity field to the tune of $776,000. Perhaps I should explain that item. If a policyholder dies, and he has a contract on which we have agreed to pay an annuity to his beneficiary, and we agree that the rate we will earn under that annuity is 3½ percent, we are not earning 3½ percent, we are earning 3.07 percent after taxes, so when each one of those contracts becomes an annuity, we reach into our surplus earnings and put into that account enough money so that we only have to earn 3 percent, which we are earning.

That cost us last year $776,000. We reserved for Federal income taxes—and here I will expose myself to your righteous indignation, because we reserved on the basis of the Mills bill—we reserved for Federal income taxes $1,822,000.

We put into security valuation reserves as required by the National Association of Insurance Commissioners $125,000, and we put into special contigency reserves and surplus a combined item of $2,352,000. That is what we did with the overall result of our company's operations last year.

Now when we added these amounts to surplus and to contingency reserve, remember that we had this in mind that a mutual company

must maintain a strong surplus, and I will give you one example as to why. We have, and I am taxing my memory now, roughly 90-some millions of United States Government bonds in our portfolio. There was a time last year when those bonds were worth $85 a hundred. We have to have surplus to guarantee the payment of our contracts and to provide for whatever may happen to any of the assets which are on our company's books, so we put into those 2 surplus accounts $2,352,000.

That is as near to answering your question as I can come without sending home and getting some figures which I will be glad to do.

Any other questions?

Senator CARLSON. Mr. Lloyd, may I inquire if Mr. Judd Benson is with your company?

Mr. LLOYD. Yes, Mr. Benson is our general agent in Cincinnati, and if it were not for what I felt was the necessity of coming to this committee and telling what these tax proposals will do to our company, I would today be in Hollywood Beach, Fla., enjoying the nice climate down there with him.

Senator CARLSON. I was wondering if this was the same company in Cincinnati, and I would like to say, that Mr. Benson testified before the House Ways and Means Committee on insurance many times and I assume the Senate Finance Committee, and in my opinion gave one of the clearest and ablest presentations on life insurance that I ever heard.

Further than that, he comes from a Kansas family which is outstanding.

Mr. LLOYD. Thank you, Senator.

Senator GORE. Do you have a copy of your financial statement?

Mr. LLOYD. I am sure I have, yes.

Senator GORE. What do you show for net investment income?

Mr. LLOYD. The financial statement that I have here is a balance sheet. It does not show that. I can give you the figures from memory.

Senator GORE. All right.

Mr. LLOYD. Our net investment income—and you are talking about an after-taxes income?

Senator GORE. No.

Mr. LLOYD. Before taxes?

Senator GORE. Yes.

Mr. LLOYD. 3.26 or 3.36 percent.

Senator GORE. What is the total of your income on an accrual basis?

Mr. LLOYD. The total of our income on an accrual basis?

Senator GORE. Yes.

Mr. LLOYD. You are talking about investment income now?

Senator GORE. I am talking about the total of your operations.

Mr. LLOYD. Including the premium deposits?

Senator GORE. Yes.

Mr. LLOYD. I would have to guess about that, Senator. I guess my guess would be pretty close and I would guess that it would be $101 million. Offsetting against that, of course, are some approximately $50 million in death claims and other payments to policyholders and other things which I do not have in my mind.

Senator GORE. Then what do you show for net gain—I won't ask you about all the deductions—what do you show as net gain from operations before dividends and capital gains?

Mr. LLOYD. Again, I am going to have to tax my memory. I think perhaps the figures I have used will be of some assistance to me. You are talking about last year?

Senator GORE. I am talking about 1957.

Mr. LLOYD. 1957.

Senator GORE. You include 1957 in your statement.

Mr. LLOYD. I will subtract the dividends from the gross surplus increase we had of twelve million two. I subtract seven million one, which leaves about five million one after dividends to policyholders.

Senator GORE. Then what do you show as net gain to surplus account?

Mr. LLOYD. We put a million dollars into special contingency reserves and $1,352,000 into our surplus account.

Senator GORE. This is your answer $2 million?

Mr. LLOYD. My answer would be that our contingency reserve account is comparable to free surplus.

Senator GORE. And that is after your calculation of taxes under the Mills bill?

Mr. LLOYD. That is right.

Senator GORE. Thank you, sir.

Senator ANDERSON. Just one further question on this use of the Mills bill.

Mr. LLOYD. Yes.

Senator ANDERSON. Do you sign the financial statement that your company filed in the various states?

Mr. LLOYD. Oh, yes.

Senator ANDERSON. The standard form contains an acknowledgement and says—

being duly sworn each for himself deposes and says the above described officers of the said insurer that on the 31st day of December last all of the herein described assets were the absolute property of the said insurer free and clear of any liens and claims thereon except as herein stated in this annual statement together with related exhibits, schedules, and explanations thereto contained annexed and referred to are a full and true statement of all the assets and liabilities and of the conditions and affairs of the said insurer as of the 31st day of December last.

Now if you used the Mills bill, was that a correct statement?

Mr. LLOYD. I think it was a correct statement, Senator Anderson, in view of all the circumstances.

Now if you want to take the position that the other thing——

Senator ANDERSON. It is not that you are caught with some uncertain values. It is what have you got?

Mr. LLOYD. I wish you would hear me out. I have never found a New Mexican who would not.

Senator ANDERSON. Maybe I vary from the general herd then.

Mr. LLOYD. No; I do not think you do.

The Mills bill at the time we signed our annual statement, at the time I signed it, had passed the House of Representatives. It was a question of which way we would reserve for Federal income taxes. We had to file these statements against an end of February date. Even as late as when this committee held its first hearing on the

Mills bill, the information which we got, and I am sure all the other companies got, was that the consideration here was the extension of the Mills bill for 1 year and the enactment of the 1950 law as permanent legislation.

I cannot say what the fact was. I can only say what was reported from reliable sources to the entire life insurance business, and I think you will find that most of the companies—and believe me, Senator, you are not dealing with companies who sign annual statements lightly.

I have been an insurance commissioner. I have been on the other side of this fence. I have pushed some of my own allies out in this audience around some, and believe me they do not sign, we do not sign statements lightly.

We are in the contract selling business. But I think we took a proper calculated business risk in the light of all the facts, and then this other thing must also be taken into consideration.

That is this 1942 act, which in the instance of our company would be a manifest injustice and would throw us immediately into a reserve earning deficit, if that act were to become the law, and we filed our income tax return by March 15 under that act which we will do if you do not take some action, we will immediately refile our statements in every State insurance department, and out of our surplus account we will pick up the additional amount of money which I read to you.

Senator ANDERSON. Five hundred and some thousand dollars?

Mr. LLOYD. Is considerable and a reserve against those taxes. I think we made a proper business deduction in the light of everything that had been reported to us.

Now here was a statute which had been enacted in 1942, and one of the things that I think must be remembered about the 1942 law is that by its own operation at one time no life insurance company or at least not more than a very few, I would say less than a dozen, paid taxes by the operation of this 1942 law.

Now if there were no other evidence against the efficacy of that statute it seems to me that that fact alone would damn it for ever.

Senator ANDERSON. Provided nothing had happened in the world in the intervening years, but something did happen, did it not?

Mr. LLOYD. There were some of us, Senator—I hate to say that I predicted this but I was one of those, and at that time I was an insurance commissioner when that bill was passed, and in conferring with our own companies about it, they came up and said "what do you think of this bill"? I said, "Gentlemen, I don't think that law will work and some day nobody will pay taxes under it" and that is exactly what happened.

State governments did not levy that law, did not enact it or it would not have been enacted I am sure.

But here is a statute which once produced so much confusion that repetitiously this Congress has intervened between the enforcement of that statute, between its effectiveness and the taxpayer, and has said not once but several times, in 1948 or 1949 and in 1950, 1951, 1952, 1953, 1954, 1955 and 1956 "no, not that one. We will put in a 1 year stop gap because that one did not work."

Now that is the record, and we felt in our shop that with such a record as that, we had a right to assume that the reporting we got out

of Washington, that we were going to get the Mills bill again for 1 more year and then go into a general discussion of this entire matter with a Treasury proposal or a Stam committee proposal or a ways and means proposal or some proposal which would put a permanent tax law on the books, we felt that we were justified in reserving under the Mills bill and in filing, and that is why we did it.

I would like to make one more statement here if I may, because out of a long history of dealing with this tax situation as a State supervisor of insurance companies, and as the executive of a life insurance company, I have one firm conviction, and that is that before this year is over, the Congress of the United States should enact a permanent tax law. It should settle this tax controversy, because you have companies all over not knowing from year to year what our tax liabilities are going to be.

Here we were last year paying a tax bill, the effective rate of which was 7—I gave you the figure from this statement—the effective rate of which was 79.87 percent of our taxable income.

Now, we should not be taxed more than the corporate rate. We should be allowed to build surplus. Nothing sticks to the hands of a mutual life insurance company as it goes through. We are a channel. All in the world we can build is strength owned by our owners, who are our policyholders, and dividends to pay to our policyholders. That is all we can do.

But, if a tax law prevents us from earning our policy-contract reserve requirements, gentlemen, I submit to you that tax law in principle is damaging to the institution of life insurance and should not be enacted, and there are many, many companies affected by each of these statutes in exactly the same way our company is affected.

Senator ANDERSON. As to why you said it, you said you had reports out of Washington. What were those reports; that everything was all set?

Mr. LLOYD. No; I certainly do not think that is the way I would describe it. I have been a member and am a member of the joint taxation committee of our industry, have been for many years. We are in conference with Treasury officials, Government officials. We read the newspapers and the services, and when I say that it was the general understanding——

Senator ANDERSEN. Was this in the newspapers that the Senate had approved it?

Mr. LLOYD. I have read that no place, Senator, and, as of this moment, I am very certain that it has not.

Senator ANDERSON. Well, what did you get?

Mr. LLOYD. I am trying to tell you, if you will let me.

Senator ANDERSON. You said the newspapers. You, yourself, mentioned it.

Mr. LLOYD. The newspapers told us that the House had passed the Mills bill.

Senator ANDERSON. Yes.

Mr. LLOYD. Our own people in Washington, our staff people here, reported to us that there would be no hearing on the Mills bill. That was the report that came to us.

Senator ANDERSON. Had they consulted the chairman of the committee?

Mr. LLOYD. I don't want to get between you and the chairman. I can only say this to you: that my understanding is that the information they had that there would be no public hearing came from the chairman's office and from the staff and, perhaps, from the chairman, himself; that this public hearing today is held because of the chairman's statement to representatives of the industry if there is going to be something considered besides the 1-year renewal of the Mills bill, we will give you a public hearing.

Senator ANDERSON. I don't know whether I can give you exactly what took place, and I am going to be subject to correction, but there was sort of a motion made by one of the members of the committee that we let the 1950 bill become effective for 1958, and it was that which brought on the hearing. The chairman said—he will speak for himself, but he said—"No; I am obligated; if we are going to place an additional burden on these companies, we will give them a chance to have a day in court." Whereupon, every member of the committee, I think, agreed that was the right position to take and a very proper one.

Mr. LLOYD. Senator, may I ask wasn't that about what I said?

Senator ANDERSON. No; you are worried about the hearing on this bill, the Mills bill. That is quite a different subject.

Mr. LLOYD. Senator, I am sorry, but I just don't want to seem to be contesting with you, but I think I must make what I said clear.

Senator ANDERSON. I am trying to find out where you got this inside information.

Mr. LLOYD. I did not claim to have any inside information.

Senator ANDERSON. You thought it so strongly that you signed this statement that your taxes were so much?

Mr. LLOYD. That is right.

Senator ANDERSON. When they are $527,000 more under the law of the land as of the 31st day of December last. You must have thought of it pretty heavily before you signed that.

Mr. LLOYD. I said to you, and I repeat to you, sir, respectfully, that I think I did a prudent thing when I signed that statement. I think I had, in the light of the history of the situation, the right to do it and some obligation to do it that way. We would have had to correct our statements one way or the other. We had to file in the State department before we filed our tax return.

My point to you, sir, was that I felt then, and I feel now that I was right then, that we, as an industry, had a reasonable right to believe that the Senate of the United States would concur with the House in reenacting this bill for 1 more year. There isn't a man in the life-insurance business who believed it would go beyond that, and there isn't a man in the life-insurance business but who is anxious to find the proper method to tax life-insurance companies, put it on the books, and keep it there. That is generally true.

The CHAIRMAN. The Chair would like to say that, whenever any member of the committee requests hearings, he always acquiesces, and we hold hearings. That is the reason we are having the hearing today.

Are there any further questions?

The next witness is Mr. Roswell Magill.

Mr. Magill is well known to this committee, and we are very glad to see you, sir.

STATEMENT OF ROSWELL MAGILL, CRAVATH, SWAINE & MOORE

Mr. MAGILL. Mr. Chairman and members of the committee, my name is Roswell Magill. I am a member of the New York bar, with offices at 15 Broad Street, New York City, and I am a trustee of the Mutual Life Insurance Company of New York.

I am appearing here today on behalf of a number of mutual life-insurance companies, simply mutual life-insurance companies, and we have submitted a considerable amount of material which, I believe, has been disbursed among you.

Having listened to the hearing so far today, I am somewhat puzzled as to exactly what procedure to follow, and I am also humbled at the amount of erudition which has already been displayed both by members of the committee and witnesses who have appeared.

I think I can, perhaps, save everyone's time by going through, rather summarily, the statement which has been filed and, I believe, has been given to each of you. I wish to touch upon the different points in it, and then, if there are questions which any of you have, why, I will be glad to see what I can do with them.

Mr. Slater, who appears here with me, is a vice president of the John John Hancock Mutual Life of Boston, and he is prepared to discuss with you more in detail the operations and characteristics of a mutual life-insurance company.

The general background I am sure you are all familiar with, and it has been brought out rather extensively here today. The companies which I represent have been working for approximately 2 years, since 1956, to try to work out what we would like to be able to call a permanent method for the taxation of the income of mutual life-insurance companies. During that period, we have had numerous conferences with Treasury officials. We have had sundry conferences with members of your own staff, with a view to getting up material, a good part of which has been given you here today.

What that material shows in substance is that savings in the form of life insurance are more heavily taxed than savings which are deposited with other institutions.

For example, 1 of the charts in 1 of the books which I hope you have before you shows that the tax burden on life insurance policy holders during 1955 was something like $519 million.

Senator FLANDERS. Mr. Magill, which book and which chart?

Mr. MAGILL. I think this perhaps recurs in a number of them. It is chart 2, and in the gray book, if that is what you are referring to, it appears after page 29.

I believe it also appears in the green-covered book as chart 2. The chart I am referring to is entitled "Comparison of Tax Burden on All Life Insurance Policyholders, 1955. It is page 30 in this gray book, incidentally——

Senator LONG. May I ask you how you arrive at that. Here is a thought that occurs to me ordinarily. If I had $5,000 invested where it was drawing interest, I would pay ordinary income tax on that $5,000.

On the other hand, if I gave it to an insurance company, wherein do I pay that much income tax on the income on my $5,000 if it is held by an insurance company on a policy?

Mr. MAGILL. I think I might answer your question in two parts, Senator.

Chart 1 in this same gray book I think shows precisely what you are speaking of.

Senator LONG. What page is that?

Mr. MAGILL. That is on page 26. It shows what the tax burden is on the income from invested savings of individuals of various sorts, and then in the second place after each of these two charts is an explanation showing how the material shown on the chart was arrived at, which I hope will answer your question.

Does that answer your question?

The CHAIRMAN. Senator Flanders.

Senator FLANDERS. May I inquire, sir, whether this chart 1, for instance, takes into account the tax bracket of the investor in any way?

Mr. MAGILL. No, sir; I think not.

Senator FLANDERS. What is the basis of it?

Mr. MAGILL. It takes it into account in this way.

We have taken into account the characteristics as shown by statistics of income, the incomes of the various individuals who own life-insurance policies.

Senator FLANDERS. I see.

Mr. MAGILL. And work it out in that fashion.

Senator FLANDERS. It is a cross section?

Mr. MAGILL. It is an average; yes.

Senator FLANDERS. Of policyholders?

Mr. MAGILL. Yes, sir.

Senator FLANDERS. Yes.

Senator ANDERSON. How is that again? The average income—we have just been hearing about the average life-insurance policy—is $1,300 or less, so do you calculate these on the basis of people who only own $1,300 worth of life insurance of all kinds?

Mr. MAGILL. No; what we have attempted to do is to work out what I will term the income characteristics of the different life-insurance policyholders from the statistics of income.

I am sure you are familiar that the statistics of income contain figures as to the number of individuals reporting for tax who report in the different income classes.

Senator ANDERSON. Do I understand this first column here, it says 13 cents per dollar of income on corporate bonds, Government bonds, mortgages, proprietorships, partnerships?

What does that mean?

Mr. MAGILL. I think it is probably a product of this, Senator: It has been computed, and I think this is shown in this text which follows the chart, that the average rate of tax applicable to a life-insurance policyholder is some 14 percent, the reason being that so many life-insurance policyholders being persons of small incomes are not taxable at all.

So if you take the average, you arrive at that low figure.

Senator FLANDERS. Is that averaged on the basis of the number of policyholders or is it averaged in some way, you have totaled up the assumed income of the whole group of policyholders and divided the number?

Mr. MAGILL. Yes. I think you add this fact: That policyholders, the life-insurance policyholders of the country, are a pretty representative cross section of the individuals of the country.

There are what, Mr. Slater, 30 million policyholders?

Mr. SLATER. 110 million policyholders.

Mr. MAGILL. Then you can see that it would be.

Senator ANDERSON. What is the point—the 0.132 in that first line, what does that mean, corporate bonds?

Does it mean the average of a life-insurance policyholder is 13 percent of the income he gets off of corporate bonds in taxes?

Mr. MAGILL. No, sir; let's start at the left.

Senator ANDERSON. I can understand tax-exempt securities. That is within the range of possibility.

Mr. MAGILL. Yes. If an individual in this country owns a corporate bond and receives a dollar of net income, the average rate of tax applicable to him is something like 13½ percent.

Senator WILLIAMS. How can that be when the starting rate is at 20 percent?

Mr. MAGILL. Because seo many of them are not taxable at all.

Senator ANDERSON. You think they own corporate bonds?

Mr. MAGILL. All I can go by is the statistics. I don't know.

Senator ANDERSON. What real reliability do you place on your own statistics?

Mr. MAGILL. This is taken from statistics of income which is published by the Bureau of Internal Revenue.

Senator ANDERSON. How many people who have an income tax bracket that they do not have to pay income taxes own mortgages?

Mr. MAGILL. I have not the slightest idea, sir.

Senator ANDERSON. How many of them are proprietors?

You have got all those categories in there and you come out with a 13——

Mr. MAGILL. You can come out to that perfectly well if you apply your income statistics from statistics of income to show what the actual effective rate of tax is on these various types of income.

Senator ANDERSON. You mean this is a hypothetical statement?

Mr. MAGILL. No, sir.

Senator ANDERSON. Do you know anybody that can get an income from corporate bonds and Government bonds and mortgages and end up with only paying 13-percent income tax?

Mr. MAGILL. The 13 percent is an average figure. That is if you take all the people in the country who own life insurance and compute the average income-tax rate to which they are subject, you come out with this figure.

Senator WILLIAMS. Do you mean that the Treasury Department only collects an average of 13 percent on all corporate interest?

Mr. MAGILL. Insofar as the sample of life-insurance policyholders—yes, sir, what you said is true. That is if you take all of the income from corporate bonds, Government bonds, mortgage proprietorships, and so forth, and then consider the total tax which is applicable to such income, you come out with this figure.

Senator FLANDERS. Is what you are telling us this: That there are so many low-income policyholders who do not own any of these things at all that the average is low?

Is that what you are telling us?

Mr. MAGILL. In substance: yes, sir.

As I understand this table, what we have sought to do here is to show the tax burden which applies to the various types of investment income, and this figure, this percentage is arrived at as I understand it by a consideration of the actual amount of tax that would be collected from the average life-insurance policyholder with respect to these various items.

Senator LONG. I do not see how you could arrive at that 0.132 figure and I will tell you why not.

My recollection is that studies indicate that 90 percent of the people of this country own no corporate stock at all, and I believe you would find that that figure is just about the same with regard to corporate bonds. It won't be far different on mortgages.

There is less than 10 percent of the people that hold any mortgages, and against that it would seem to me that you would arrive at that 0.132 you have to take those investments and average those in with postal savings, for example, and with Government bonds where you have a lot of small holders holding series E bonds and things like that to ever arrive at that 0.132 figure.

You are taking different types of investments.

Now if you are trying to say that your insurance companies should be taxed at a lesser rate than people with postal savings, I am not sure that that is something that it can be compared to. By the time you lump all those things together to arrive at an average I do not think you do anything more than mislead us.

Mr. MAGILL. What you suggest is not our purpose.

Senator ANDERSON. What is your purpose by this?

What does this show? How does this shed any light on whether or not the Mills bill should be passed or whether we should leave the 1942 law in operation?

Mr. MAGILL. I am not sure that it does, sir.

Senator ANDERSON. What is it doing here then? Is this a smoke-screen of some kind?

Mr. MAGILL. May I say the reason we have this is this: We started in some 2 years ago at the request of the companies, the staffs and so on, to try to work out first what is the income of mutual life-insurance companies which might be taxed and what would be a fair and reasonable method of taxation, taxing such income.

Now in the course of working on that, what I referred to first, chart 2, is the item that we are more principally concerned with.

That is that if you look at other types of savings institutions, the income of a person who can save by means of life insurance is more heavily taxed than the income of persons who resort to other forms of savings.

That is also shown by chart I.

Now I did not do these, and whether or not they are right depends on the text following the chart, but we are pretty sure they are right.

We have worked with them for a long time.

Senator LONG. My impression about it is what I would like to tax is not particularly the part that the person puts in and gets back out but the part that stays in the company.

Mr. MAGILL. I think you are quite right.

Senator LONG. The sort of thing I have in mind is that when a man takes out a $10,000 policy on the average he makes his payments and you invest that money at interest and that he pays you less than $10,000 but if you include the interest you have made on the money while you have held it you have more than $10,000 when he dies and his wife gets the $10,000. There is more money left in company which adds to the company's reserves after the company pays off the widow.

At least that would be my impression.

Mr. MAGILL. I think you are correct as far as what is the nub of the matter.

The point of view at which we arrived after working at the thing for a while was that the only income which mutual life-insurance companies had was the so-called investment income, that premiums are not income. That point, of course, has been discussed by previous witnesses and I do not think I have to state it again.

Senator ANDERSON. What we are interested in trying to find out from you is here is a group of companies that owe the Federal Treasury $415 million.

They want to settle the bill for $291 million. You tell us why the Treasury should take it.

Mr. MAGILL. You have certainly put the question the hard way, Senator.

Senator ANDERSON. No; the others have been putting it the easy way. The Mills bill is not in effect.

Mr. MAGILL. That is right.

Senator ANDERSON. It is a proposal?

Mr. MAGILL. That is right.

Senator ANDERSON. The tax liability, and this company from Virginia very properly put it into its bill, the tax liability is $415 million.

Now the companies here would like to settle that for $291 million. Senator Kerr the other day would like to have hiked it to $536 million.

Well, eliminate the $536 for the minute and just tell why they should get that $124 million knocked off their bill.

That is what we would like to know.

Mr. MAGILL. I was trying to go the short way around but I guess I made it too long even so.

Let me try to answer you directly. I do not think any of us here, at least I know what my own position would be, I do not think any of us here regard this so-called stopgap legislation as a permanent matter of legislation.

What I have in mind to say is this: That for 2 years we have been trying to work as best we could with the Treasury and the staff of the committee trying to work out a permanent mode of legislation.

And as you know, the Treasury has promised you from time to time that they were going to come up with such a thing and the promise this morning was they would have it within 30 days.

Well, we will welcome that as much as they will, and we will be very happy to work with them to whatever extent they wish us to.

Now, here we are with the 15th of March practically here, at which time a return has to be made under the existing law to which reference has been made.

That being true, we do not see that it is really practically possible to work out a permanent method for the taxation of insurance companies in the remaining time, and therefore we feel, and I can state it

a little more strongly than the Treasury representative is willing to, that the only practical possibility we see is to adopt the stopgap legislation at this time for the year 1957 so that we will have a few additional months in which to work up permanent legislation for the taxation of insurance companies.

Senator ANDERSON. But you recognize there is also the possibility that you could pay the tax bill too?

Mr. MAGILL. Oh, quite so.

Senator ANDERSON. Almost every person when he gets to that income tax today could see the possibilities of having his tax cut 30 percent but he also can pay them.

Mr. MAGILL. I think we have this equity. That since 1950 there have been a series of stopgap bills, that is that it has been thought for many years that the law on the books was not going to work very well as far as life insurance companies are concerned, so there have been a series of stopgaps.

Now that is not a happy history as far as that is concerned, but it does illustrate that there have long been attempts to supplant the 1950, which goes back o 1942, legislation with some other legislation.

Senator WILLIAMS. But each one of these stopgap bills passed with the understanding that that was the last?

Mr. MAGILL. I have not been here that long, sir. I think this is a little peculiar in this: That the assurance which I believe you gentlemen have at least long sought, and perhaps as long as you suggest, the assurance which you sought has come from the Treasury, but the companies whose tails are really in the gate are the life insurance companies.

Senator ANDERSON. Yes, but the Treasury says they will be up here in 30 days with a bill.

Mr. MAGILL. I certainly hope they are right.

Senator ANDERSON. When they are up with that bill then we will get the parade of the widows and orphans again.

Life insurance policyholders it will be said, have undue tax burdens, and the real lobbying will start to try to kill any bill. They might come along and say we are not going to try to get by with 291 million; we might say 400 million.

Mr. MAGILL. I suspect you have made it pretty nearly impossible for another stopgap to be suggested.

Senator ANDERSON. Well, that would be something.

Mr. MAGILL. I quite agree with you. I think that is something.

Well, I am not sure just where to go on.

Senator ANDERSON. I have not exactly heard you say what financial difficulty is going to be imposed on any company by having to pay what the law requires them now to pay and why they should have this remedial legislation.

Mr. MAGILL. I think that perhaps is as well explained by my predecessor as anyone could explain it. That is as we see it, I believe we are correct in this, the weight of whatever tax is imposed on mutual life insurance companies must be paid by the policyholders.

There is no other place it can be paid. Therefore, if the tax rate is quite seriously increased over what has been paid in the past, which it would be if the existing law went into effect, the effect would be to materially reduce the policy premium refunds which are otherwise

commonly called dividends that would otherwise be paid to policyholders, and the cost of insurance will increase by so much.

Senator ANDERSON. In 1946 and 1947 no tax was paid.

In 1956 a substantial tax was paid.

Mr. MAGILL. That is right.

Senator ANDERSON. Were the dividends reduced between 1946 and 1947 and 1956?

Mr. MAGILL. I doubt if they were between 1946 and 1956, because among other things you had had considerable changes in many other conditions.

Senator ANDERSON. Then it did not come out of the dividends to the people at all, did it?

Then this Aunt Jane and Aunt Mary did not have to pay it, did they? They did not pay anything in 1946 and 1947. They paid $700 million in 1956. Did the dividends of the insurance companies go down?

Mr. MAGILL. I doubt that they did.

Senator ANDERSON. Don't you know that they did not?

Mr. MAGILL. No, sir. I am not an expert on mutual life insurance companies generally. I know in my own case the dividends have been going up.

Senator ANDERSON. The more the tax the dividends go higher then?

Mr. MAGILL. We have certainly been paying more taxes and the dividends have increased.

Senator ANDERSON. That is fine.

Mr. MAGILL. But that of course is due to a variety of other circumstances such as changes in the interest rate, changes in mortality and so on.

Senator ANDERSON. Lengthening of human life and a great many other things?

Mr. MAGILL. That is right.

Senator WILLIAMS. Did you increase the dividends in 1947 and 1948, years in which you paid no tax?

Mr. MAGILL. I doubt it. I do not know, sir, but I doubt it.

Senator ANDERSON. Is there anybody here that does know about the dividends?

Mr. MAGILL. Mr. Slater might know.

Senator ANDERSON. Tell us, Mr. Slater. You did not pay any tax in 1946 and 1947. Last year you paid $26 or $27 million. Did you have to cut the dividends?

Mr. SLATER. The John Hancock in 1947 did increase its dividend scales. There are many other factors involved, and because of greater interest earnings, because of higher average sized policies, greater efficiencies, the company has not needed to cut any dividend scales, but it has not increased them to the extent that we would have liked to increase them.

Senator ANDERSON. But you did not have to cut?

Mr. SLATER. We did not have to cut.

Senator ANDERSON. This awful tax burden did not take these poor people walking up and down the streets and take their bread away from them?

Mr. SLATER. We think the tax burden, sir, is quite heavy, and we find that——

Senator ANDERSON. I understand that.

Mr. SLATER (continuing) That there is a tremendous drift away from life insurance.

Senator ANDERSON. There is away from life insurance?

Mr. SLATER. Away from the investment-type life insurance toward term insurance, yes, sir.

Senator ANDERSON. I thought I saw quite an insurance statement here a while ago that life insurance was never in such a boom as it is today.

Do you dispute that?

Mr. SLATER. Not the specific statement, no, sir.

Senator ANDERSON. No?

Mr. SLATER. But the increase in the assets of life insurance was less in 1957 I think you will find that at any time during the last decade, assets, not insurance in force.

There is a tremendous trend toward term insurance away from the so-called investment type of contract, and one of the reasons for that is the heavy tax burdens.

The CHAIRMAN. Mr. Magill, have you completed your statement?

Mr. MAGILL. I have virtually completed it, yes, sir. We favor the enactment of the stopgap legislation for the year 1957. We are very anxious to sit down with the Treasury and with the staff of this committee to work out a permanent solution to this problem.

Our main submission is that the amount of income which is available to tax is at most the gross investment income minus the expenses that the company has to meet and minus the additions to reserve which have to be made.

A part of these amounts are currently taxable to individuals through the methods of taxation now imposed with respect to annuities and various installment payments, and that would have to be taken into account also.

We do believe that a permanent system can be worked out, and we hope that the stopgap legislation can be enacted for another year to enable that to be done.

Senator ANDERSON. And you say they have been working for 2 years with the Treasury?

Do you know what stopped getting it done?

Mr. MAGILL. I do not, no, sir.

Senator ANDERSON. Is it that the Treasury wants one type of taxation and the companies do not like that style?

Mr. MAGILL. I do not think the Treasury has ever proposed a style of taxation.

Senator ANDERSON. Not as a final decision but with the staff group working?

Mr. MAGILL. I have never seen one.

Senator ANDERSON. Weren't any suggestions gotten out at all from the five working down here?

Mr. SLATER. I was not 1 of the 5.

Mr. MAGILL. I have never seen any definite proposal by the Treasury.

Senator ANDERSON. I thought we had a statement that five actuaries came down here?

Mr. MAGILL. You did. I think that is in the record.

Senator ANDERSON. Is there anybody who can testify what they did?

Mr. MAGILL. I think you would have to get 1 of the 5. I do not know who they were.

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

The next witness is Mr. Robert E. Slater, vice president of the John Hancock Co.

STATEMENT OF ROBERT E. SLATER, VICE PRESIDENT, JOHN HANCOCK MUTUAL LIFE INSURANCE CO., BOSTON, MASS.

Mr. SLATER. If I may, I would like to stand because of the conditions here. I would like to say I am the vice president of the John Hancock Mutual Life Insurance Co., of Boston, Mass., and I happen to be an actuary, although not 1 of the 5 distinguished actuaries that were referred to.

But I would like to for a few moments discuss with you what a mutual life insurance company is, and also what comprises them.

A mutual life insurance company, the purpose of a mutual life insurance company—and I might say that I did file a statement.

I am going to try for the sake of time to shorten the statement down. The purpose of a mutual life insurance company is to provide protection against the hazards of untimely death, disability, and dependent old age at the least possible cost without profit to anyone. The policy owners as individuals have united and pooled their savings to provide this service. A distinctive feature of a life insurance company, a mutual life insurance company, is that there are no stockholders.

Now payments which are capital deposits made into the pool of savings by the policy owners are calculated with due consideration to mortality, investment and expense rates, so that the deposits made will, with the investment earnings, be sufficient to provide the benefits guaranteed in the policies.

Customarily the capital deposits required of the policy owners for a given policy remain level or nearly so throughout the duration of the contract, while the probability of benefit payment increases substantially with time.

Consequently the premium deposits or capital deposits of a given group of policy owners are more than sufficient to pay the claims in the early years and less than sufficient to pay the claims in the later years.

Thus unused savings of sufficient amount from the capital deposits of the early years are retained by the company to provide the later deficits.

These funds are invested to yield the maximum advantage to the policy owners, and life insurance is, therefore, as we see it, the deposit, the investment, and the return of savings.

Now the assumptions that are made in a mutual life insurance company with regard to interest, mortality, and expense rates are necessarily on a conservative basis, so that when the experience unfolds, there is more than sufficient funds on hand to meet the payments.

Therefore these unused portions of capital deposits are returned to the individual policy owners. These disbursements which are referred to as policy dividends are in effect the return of capital de-

posits previously made. And by law we are required to calculate these dividends and disburse them on a yearly basis.

The income that is yielded by the investments in a mutual company cannot accrue to the benefit of anyone other than the policy owners of the company. As the interest earnings are received, they are merged with the capital deposits so that the total funds on hand are sufficient to pay the policy benefits. Eventually all funds, whether they be investment earnings or capital deposits, are paid out to the policy owners.

There is no ultimate withholding of funds in a mutual life insurance company.

Senator LONG. How did you go about determining how large your reserves ought to be?

Do you do it strictly as a matter of the law telling you that?

Mr. SLATER. The law prescribes minimum policy reserves.

Senator FREAR. Which law, State or Federal?

Mr. SLATER. State law, and the different States have different laws. I believe the maximum interest rate that you can use is 3 percent or 3½, something on that order.

Senator FREAR. In what State is your company incorporated?

Mr. SLATER. We are domiciled in the Commonwealth of Massachusetts.

Senator FREAR. Do you pay State taxes in any State other than Massachusetts?

Mr. SLATER. We pay State taxes as I understand it, sir, in all 48 States of the country.

Senator FREAR. You are privileged to pay taxes wherever you do business.

Mr. SLATER. That is correct. We are a nationwide concern. We are not a small concern. I would like very much to say, the John Hancock is one of the large life insurance companies.

The John Hancock has assets of over $5,100 million at the end of 1957. Judged on these facts alone, the John Hancock might be adjudged to be a large and a wealthy corporation.

Senator FREAR. How many policyholders do you have?

Mr. SLATER. We have over 10 million policy owners, and we believe who these people are is very important.

The average sized policy in force in the John Hancock is $1,085.

Senator FREAR. That is a little below the average?

Mr. SLATER. I would say, yes—the average is $1,555—so percentage-wise I would say it is considerably below the average.

Now 1957 was what I would call a good year for the John Hancock.

Senator WILLIAMS. Might I ask what percentage of your policyholders are below $10,000, in dollars?

Mr. SLATER. I was just going to come to that figure if I may. I analyzed the new issues of the John Hancock for the first 10 months of 1957. I cannot give you the breakdown of policies in force but I can give you the new issue, and I think that the issue would indicate a higher percentage of larger policies than the in-force figures. Fifty-one percent of the policies issued in this 10-month period, and it was 784,000 policies issued, 51 percent were for less than a thousand dollars.

Ninety-seven percent of them were for less than $10,000. One-tenth of 1 percent or 800 out of 784,000 policies were issued for amounts of $50,000 or more.

Eighty-seven percent of the so-called ordinary policies were issued for amounts less than $10,000.

The John Hancock is a large corporation. We are large not because people having large financial resources have pooled their resources, but rather because so very many persons of modest incomes have contributed to the John Hancock pool for mutual security.

Senator MARTIN. Did that include group insurance?

Mr. SLATER. The policies I am referring to are so-called individual policy owners and do not include the group coverages which are in the main provided for by the employer.

The average certificate I think in group in our company would be on the order of $1,800.

Senator FREAR. Are your percentages by policy holders or owners, not by dollar volume?

Mr. SLATER. By numbers of policies.

However, sir, I do have one figure that might give you something on the side of amount. I said that 97 percent of our policies were for $10,000 or less.

Senator FREAR. Yes.

Mr. SLATER. That is 90 percent of the volume of our business. In other words, the John Hancock is a workingman's company, and we are a mutual company. The tax that is paid by the John Hancock is absorbed and must be paid by the policy owners. If I might say just one word about these charts, that were discussed earlier by Mr. Magill. I was one of those that was burdened with the problem of doing this, that we determined first of all what was the average tax bracket of a policyholder in a life insurance company, the average tax that he is paying on his gross income.

Then we assumed that if the policy owner who has placed his savings in life insurance went into other areas of investment, taking that average rate, we compared that with what the tax burden is in a life-insurance company, so it is a comparison that does not assume that any one at all in this bracket owns corporate bonds, but our tax is a tax that we as a company must pay for them and is in effect a withholding tax.

Senator ANDERSON. You do not know of any group of citizens who own corporate bonds that pay only 13 cents per dollar of income?

Mr. SLATER. The average policyholder pays a 12 percent tax rate plus a 10 percent State tax which is 13.2 that you have here, sir, in the life-insurance company. We are saying that if that same individual who places his savings in life insurance put his money in these other types of investments, and then we are comparing the tax burden on all other forms of savings, had he put his money in them compared to the columns on the right that he is paying in a life-insurance company.

Senator ANDERSON. This does not mean that he actually does not; it is just if he did?

Mr. SLATER. That is right, sir.

Senator ANDERSON. It is like saying that the gasoline consumption is so many miles a gallon if everybody owns a Cadillac all across America, but they do not all own one.

Mr. SLATER. But we are trying to make comparisons, sir, with what he does have, which is the column on the right, which is life insurance.

Senator ANDERSON. You have taken a figure of 12.5 percent which is what the average life-insurance man pays, and then he assumed that he is going to own all these things?

Mr. SLATER. No, sir. It assumes that if he put his money in these other forms of investment, as I understand it——

Senator ANDERSON. Does the person who only has 12.5 percent income tax to pay an individual doing much outside investing or is he trying to take care of the bare necessities of life?

Mr. SLATER. That is right.

Senator ANDERSON. Then what relationship has this got to the problem.

Mr. SLATER. The only relationship, sir, is that if his money was placed in these other items, this is what the tax burden would be compared to what the tax burden he must pay on life insurance.

Senator LONG. I would like to get a little more full answer to the question. I asked you how you arrived at your level of reserves. You told me that you had a minimum level by State law. I think it would help me in my thinking more just to understand your problem here if you will tell me, comparing this $5 billion in assets that your company holds, what would the reserves required by the law of Massachusetts be?

Mr. SLATER. Our policy liabilities are something on the order ——

Senator LONG. But the State of Massachusetts tells you by law how much reserves you have to have to do the volume of business you are doing. They tell you a minimum figure, unless I misunderstand you. What would that be as related to your present volume of business?

Mr. SLATER. I would say the policy reserves we are talking about, for the John Hancock is roughly $4 billion. The minimum reserve standard, which we do not assume to be an adequate standard, would be—and I must say I am making an estimate—would be $3½ billion. However, I might say that I don't think that this has any bearing on the question of Federal tax. Interest required, sir, can be so determined for example in two different setups. In one instance you can have a case where the amount of interest required to maintain reserves is nothing, you would assume a zero interest rate, and in another instance assume a 6 percent rate, you could vary your mortality factor so that the solvency of the company and the stability of the company would be precisely the same.

But in one instance you would require a tremendous amount of interest earnings to maintain reserves, and in the other instance require none at all.

We do believe that the tax should be based on the net increment of vaule to the policy owners which is the investment income less the expenses of operation, regardless of reserve standards used.

The CHAIRMAN. Have you completed your statement?

Mr. SLATER. I have, sir.

The CHAIRMAN. Are there any questions?

Senator BENNETT. Does this witness have a formal statement which has been submitted for the record?

Mr. SLATER. I have, sir.

Senator BENNETT. Did you submit your statement for the record?

Mr. SLATER. Yes, and I tried to brief it for you.

The CHAIRMAN. Do you desire that your complete statement be put in the record?

Mr. SLATER. I turned it in, sir and wish it to be made a part of the record.

The CHAIRMAN. Without objection, the statement will be put in the record.

(The prepared statement referred to follows):

MUTUAL LIFE INSURANCE COMPANIES

By Robert E. Slater, vice president, John Hancock Mutual Life Insurance Co.; fellow, Society of Actuaries; testimony given in conjunction with Mr. Roswell Magill on behalf of some 28 mutual life insurance companies representing 40 percent of the assets of all life insurance companies

Mutual life-insurance companies were first founded in this country around the middle of the 19th century. Today, they bulk very large in the total life insurance picture. Of the more than $400 billion of life insurance in force in the United States, mutual companies account for two-thirds. They hold almost three-fourths of the total assets of all life-insurance companies and pay approximately three-fourths of the Federal income taxes assessed against the industry.

The purpose of a mutual life-insurance company is to provide protection against the hazards of untimely death, disability, and dependent old age at the lowest possible cost and without profit to anyone. Policy owners as individuals have united and pooled their savings to provide this service. The distinctive feature of mutual life-insurance companies is that there are no stockholders.

It is important to realize that life insurance is the necessity of those who have modest incomes and who desire by independent means to provide security for their families. There are in the United States approximately 110 million policy owners. This means that over 60 percent of all Americans, adults and children, are protected by life-insurance policies. Life insurance is often the only form of savings maintained by a family. In the aggregate, life insurance forms the largest pool of institutional savings in the American economy.

At the end of 1956, the average benefit to be paid in the event of death from a life-insurance policy was only $1,555. The average amount of savings represented by this policy is but $286. The average American family had only $7,600 of life insurance in force at the end of 1956.

Perhaps this point of discussing the average American owning life insurance can be best clarified by specific illustrations, and for such an illustration let us take my own employer, the John Hancock Mutual Life Insurance Co., of Boston, Mass. Measured by the amount of assets, the John Hancock is the fifth largest life insurance company in the world. At the end of 1957, the total assets of the John Hancock exceeded $5,100 million.

Certainly the John Hancock based upon these facts alone might be adjudged to be a large and wealthy corporation; but it is most important to consider what makes up its size and wealth. Let me point out that no one has any financial interest in the assets or income of the company other than the more than 10 million policy owners. For every dollar of resources in the John Hancock, there is a corresponding dollar of liability to the policy owners. The average amount of insurance in force on individual policies in the John Hancock is only $1,085 and the average premium paid per year to keep these policies in force is only $35. The average reserve, representing the average savings per policy, is but $205. This compares with the average amount of $1,856 deposited in mutual savings banks at the end of October 1957.

I have analyzed the new policies issued in our company for the first 10 months of 1957 and let me say that the John Hancock had a good year. It is quite interesting to realize that of 784,000 policies issued during this period, 51 percent of them were for amounts less than $1,000, 97 percent of them were for amounts less than $10,000 and only one-tenth of 1 percent or approximately 800 out of 784,000 were issued for amounts more than $50,000. Eighty-seven percent of so-called ordinary policies issued during this period were for amounts less than $10,000. In light of these figures, it would be hard to prove that life insurance

in the main is other than the necessity of those of modest means. The John Hancock is a workingman's company, and any tax imposed upon the company must be carried by these people of modest incomes. We do not object to paying a fair tax for our policy owners, but we cannot consider a tax levied on these people at corporate rates to be a fair and equitable tax.

This situation is not peculiar to the John Hancock. This same general picture for the same type of insurance would be true of most life insurance companies. In fact, the two largest life-insurance companies in the United States, both mutual companies, would, if analyzed, present figures virtually the same as the John Hancock. Combined, these two companies and the John Hancock have 36 percent of the life insurance in force in the United States.

These figures show clearly that the people maintaining insurance protection through our company are average American citizens and, in the main, of modest incomes. The John Hancock and other life-insurance companies are large not because individuals having large financial resources have pooled those resources, but rather because so very many persons have contributed from their modest incomes to the pool for mutual security. The nature of this pool of funds is worthy of examination.

Payments, which are capital deposits, into th pool by policy owners are calculated with due consideration for mortality, investment and expense rates, so that the amount of the deposits made will with investment earnings provide for the benefits guaranteed in the policies. Customarily, the required capital deposits for a given policy remain level, or nearly so, through the life of the policy, while the probability of benefit payment increases substantially with time. Consequently, the premium deposits for a given group of policy owners must be more than sufficient to pay the claims in the early years and less than sufficient to pay them in the later years. Thus, unused savings in sufficient amounts arising from the capital deposits of the early years, are retained by the company to cover later deficits. These funds are invested in order to yield the maximum advantage to the policy owners. Life insurance in its very operation is, therefore, basically the deposit, the investment, and the return of savings.

In a mutual company, in order to provide proper safeguards the assumptions made with regard to mortality, investment and expense rates are on a necessarily conservative basis and, consequently, the capital deposits required of policy owners will usually be found somewhat more than sufficient to cover the policy benefits as the experience unfolds. The unused portion of the deposits are returned by a mutual life-insurance company to the individual policy owners. These disbursements are referred to as policy dividends although they are, in effect, a return of capital deposits previously made. Most commonly, policy dividends are required by law to be calculated and disbursed on a yearly basis.

It is clear that the income yielded by investments, in a mutual company, could not accrue to the benefit of anyone other than the policy owners. As these earnings are received, they are merged with the capital deposits to provide a total fund sufficient for future benefit payments. Eventually all funds, whether from capital deposits or from interest earnings, after deduction of the expenses of operation, are paid out to the policy owners. There is no ultimate withholding of funds in a mutual life insurance company. This necessarily follows from fulfillment of the basic function of the life insurance operation.

The CHAIRMAN. The next witness is Mr. Richard C. Guest, vice president of the Massachusetts Mutual Life Insurance Co. You may proceed, sir.

STATEMENT OF RICHARD C. GUEST, VICE PRESIDENT, MASSACHUSETTS MUTUAL LIFE INSURANCE CO.

Mr. GUEST. Mr. Chairman, this testimony is very short and it is submitted in the name of Mr. Kalmbach, if that is all right, for the record. I am just reading it for him.

The CHAIRMAN. We won't hold it against you.

Mr. GUEST. My statement is on behalf of the Massachusetts Mutual, which was incorporated in 1851, is licensed to do business in all of the States of the Union, and which had $6,014,341,046 of life insurance in

force and $2,075,530 of assets on December 31, 1957. The company is completely owned by its policyholders. In support of the extension of the Mills law for life insurance companies, H. R. 10021, I shall limit my brief remarks to only a few phases of the problem.

THE MAGNITUDE OF THE PROPOSED 1958 TAX IN RELATION TO DIVIDENDS PAID TO OUR POLICYHOLDERS

Upon the basis of taxation in effect for the years 1955 and 1956, the Federal income tax related to our 1957 operations amounts to $5,551,013. This sum is about $750,000 greater than what it was only 2 years ago, which indicates that under the 1955–56 basis of taxation the Federal Government would receive a steadily increasing income resulting from the natural growth of the life insurance industry. Under the 1950 law, which I understand is being thought of in some quarters, our 1957 tax would be increased by $4,683,000 to $10,234,000. Such a large increase, which amounts to nearly 14 percent of our current year's total dividend disbursement, would have a serious impact upon our company.

Our net for the calendar year 1957 from operations after policyholder dividends, after taxes, and excluding capital gains and losses, was $4,854,521. Hence, if our 1957 operations had been taxed under the 1950 law, we would have had practically no funds available for contingency reserves or surplus, in spite of the fact that we considered it a reasonably satisfactory year. Such a drastic increase in our taxes would, of course, require a reduction in our dividends which, during a period of increasing interest income and favorable rates of mortality, would be difficult to explain to our more than 600,000 policyholders.

Senator BENNETT. May I ask a question? When you say after taxes, referring to your 1957 operations, do you mean that that is the figure you have calculated if the Mills law is continued, as your tax base for 1957?

Mr. GUEST. Yes.

Senator BENNETT. Thank you.

Senator ANDERSON. If the Mills law is passed?

Mr. GUEST. Yes.

Senator BENNETT. You have calculated that figure, that they will have $4,854,000 after they have paid taxes on the basis of the Mills law?

Mr. GUEST. Yes, and to anticipate your question, we placed as a liability for taxes, we used the Mills law basis.

Senator ANDERSON. Why did you do that? Had you gotten some of this inside dope?

Mr. GUEST. No, we did it on our own. We decided our dividend policy early in the summer. We have to do that in order to mechanize the thing, and we made our decision on that assumption. We thought it would come about, and when we came to the year end to set up liabilities, it looked a little skittish, but we put it in on the basis of the Mills law, and we have an $11 million item in unassigned surplus, which is for the fluctuation of mortgage loans and real estate, and we figured that with this close a margin, whether it be just $4.8 million, in a company of our size, that if we did raise the tax liability; we could cut down that $11 million voluntarily to offset it. It would not have had any effect upon the published divisible surplus.

Senator ANDERSON. I don't follow here which is the difference in your 1942 and the Mills bill.

Mr. GUEST. I haven't given you that yet.

Senator FREAR. Mr. Chairman, I am sorry I didn't get the witness' name.

The CHAIRMAN. Mr. Richard C. Guest, vice president of the Massachusetts Mutual Life Insurance Co.

Senator FREAR. You know in the testimony that Mr. Smith of the Treasury gave, he said that the Treasury Department had brought in, I believe, five actuaries from the insurance companies. Do you know who they were, sir?

Mr. GUEST. Yes, sir; I do. I was one of them.

Senator FREAR. I was wondering if the Chairman had any access to that information when he asked you that question, I mean, the Senator from New Mexico. Did you do anything down there, sir?

Mr. GUEST. Do you want me to digress, Mr. Chairman, for about 2 minutes on that question?

The CHAIRMAN. Answer the question as to what you did or did not do.

Mr. GUEST. We were called, as you were told this morning, as individuals and not as company executives. As a matter of fact, we had an arrangement, each one of us, the three company men, that we would be relieved of duties to whatever extent was required by the Federal Government. Frankly, we thought that we would have possibly an extended tour of duty in Washington, maybe a week at a time or something of that sort. We were called early in January of 1956, and at the first session a memo outlining a consideration of principles which would relate to the total net income approach to taxation was submitted to us.

Senator ANDERSON. What is that phrase?

Mr. GUEST. Total net income approach, like the general corporate approach, all types of income.

Secretary ANDERSON. That is the one the Treasury has?

Mr. GUEST. Yes. It was not a method of taxation. It was considerations which undoubtedly would have to be taken into account in that connection. Now that memo, which was extremely carefully prepared, actually, over that meeting and five subsequent meetings, the last one being in June of 1956, was the nub of what we talked about, and in that connection we considered that we were not there to write a tax bill or to design a tax system. We believe that we were willing to of the Federal technicians and the Congress. But we were willing to give any amount of time required to cooperate and to collaborate with the Federal group.

We had 5 of us, 3 company men and 2 staff men. The Treasury was represented by Mr. Dan Smith and Mr. Williams and Mr. Slitor and Mr. Oakes, and occasionally 2 or 3 others. Mr. Stam was there some of the time. He opened the meeting but then turned it over to Mr. Smith. Dr. Brannon was with him and others, and frankly we had a nice friendly time after the first session or two, although we only had six sessions all told. As I remember it, two of those were not a full day.

Now it came June and in May a summary had been written by someone, I don't know who, maybe Mr. Slitor or Mr. Stam can tell us who wrote it, but a summary was written to sort of be a guide-

post to some decisions, and we had a meeting in June at which we thought some of those things would be discussed more concretely. It was rather a short meeting. No conclusions were arrived at.

Senator FREAR. June 1956 or 1957?

Mr. GUEST. June 1956. These meetings were all in the first 6 months of 1956. We were told that we would not be called back in all probability during July and August. We thought we might be called back in September. We weren't. We haven't been called since. We don't know how much activity has been going on. As was said this morning, if you would wish, I suppose we are still on call. I don't know how much help we can be, but we are still on call. Does that answer the question?

Senator FREAR. I will tell you it is very enlightening to me, sir. Thank you.

Senator ANDERSON. You say nothing happened at the meeting in June 1956. Did anything happen in July of 1956 that changed the picture?

Mr. GUEST. We have not been in contact with the Federal group since June of 1956 in any form.

Senator ANDERSON. In July of 1956 didn't they pass what they call this stopgap legislation?

Mr. GUEST. Oh yes.

Senator ANDERSON. To continue the Mills bill? Therefore, there wasn't any point in having any more meetings?

Mr. GUEST. It wasn't at our volition, sir.

Senator ANDERSON. You wanted a higher tax?

Mr. GUEST. No.

Senator WILLIAMS. Did you endorse passing the stopgap at that time, the industry?

Mr. GUEST. Yes.

Senator WILLIAMS. That is what I thought.

Mr. GUEST. You see, at that time I was wearing 2 or 3 hats. I was working as an adviser to the Federal Government and occasionally in a session with our executive officers as to what stand we might take on taxes, but believe me, sir, I think that the men who collaborated with Mr. Stam and Mr. Smith and the others tried to be as objective as they possibly could under the circumstances.

Senator ANDERSON. Did you ever propose a change in the type of legislation, a new method of taxation or anything?

Mr. GUEST. In those discussions?

Senator ANDERSON. Yes.

Mr. GUEST. No, sir.

Senator ANDERSON. Did any member of your group ever propose that?

Mr. GUEST. No, sir. We didn't think it was our job. We were brought in to discuss and help them to devise something themselves, but we never were charged with that responsibility. We never were asked by the Federal group and it wasn't expected by our companies that we would do so.

Senator ANDERSON. And when the Treasury talked to you about this total net income basis for taxation, were you opposed to it?

Mr. GUEST. We didn't express any opposition to it. We adjusted individual features of it. The only thing that we said in our discus-

sions was it is not to be construed if we do discuss it in great detail that we are for it. But we never opposed it in the committee group.

Senator ANDERSON. Did it involve additional taxation to the insurance companies over the so-called Mills bill?

Mr. GUEST. I think one of the big problems is that it would involve probably less taxes to some and more to others. I don't think you can make a universal statement.

Senator ANDERSON. Isn't that the way life seems to work on income taxes, where some pay more and others pay less?

Mr. GUEST. Probably so, yes.

Senator ANDERSON. You never heard of it again since June of 1956?

Mr. GUEST. Not from Washington. I have had quite a lot of ribbing by friends, of course.

The CHAIRMAN. Do you know whether any other committee has been appointed since then?

Mr. GUEST. Not to my knowledge, and by the way, we never were organized as a committee. We had no chairman, we had no secretary, no records.

Senator FREAR. You may be fired and don't know it.

Mr. GUEST. I suspect I am.

The CHAIRMAN. You may proceed, Mr. Guest.

Mr. GUEST. You, of course, know that life-insurance operations have traditionally been supervised by the States, and, as a consequence, the States have considered the life-insurance business an important source of general income. In fact, the cost of supervision is a very small percentage of the State premium taxes. In the Massachusetts Mutual we find that our State premium taxes are 2.05 percent of premiums less dividends paid to policyholders. The Mills law, if it had been reenacted for 1957, and that will have to be written in here to make it complete, would amount to 3.37 percent of premiums, less policyholder dividends. Hence, even on the basis of the Mills law, the total of these 2 taxes is 5.42 percent, which we believe is an excessive proportion of our premium income. If we apply the 1950 Federal tax formula to the 1957 operations, the percentage for Federal taxes would go to 6.45 percent, and the total would then amount to 8.50 percent of premiums less dividends. It would be a terrific shock to the millions of policyholders in companies of our type if such a proportion of their net premium deposits were drained off for these two tax purposes.

Senator LONG. Let me get this straight. You say:

> If we apply the 1950 Federal tax formula to the 1957 operations, the percentage for Federal taxes would go to 6.45 percent.

Does that mean 6.45 percent of what, of your investment income?

Mr. GUEST. Of our premium deposits less dividends to policyholders.

Senator FREAR. How do you regulate your dividends to depositors or to your policyholders?

Mr. GUEST. We try on the average to pay the dividends to such a level and with equity to all policyholders, such a level that the surplus added for extra safety beyond the reserves amounts to about 6 percent of the increase in the assets for the current year. You can't always hit it on the nose. This year we didn't hit it. We were low.

This was a dividend change year. We increased the dividends 4 or 5 million dollars a year. This year we didn't hit it. We were low. Next year or the year after we might get a little over 6 percent.

Senator FREAR. Your dividends can and do fluctuate?

Mr. GUEST. Oh, yes.

Senator FREAR. And the dividend is established by the officers of the company?

Mr. GUEST. Pardon me.

Senator FREAR. The dividends are established or prorated by the officers of the company?

Mr. GUEST. They are voted by the board.

Senator FREAR. Proposed by the officers?

Mr. GUEST. That is right.

Senator ANDERSON. Have your dividends remained fairly steady through these years or have they been going slowly upward or slowly downward?

Mr. GUEST. Ours have been going slowly upward, like most companies, for two main reasons: one, the mortality rates have been improving a great deal in the life-insurance business; and the other one, the interest earned on invested assets has been increasing.

Senator ANDERSON. You had no tax during 1947 and 1948?

Mr. GUEST. That is right.

Senator ANDERSON. And yet your dividend rate when you started to pay these very substantial taxes has still be going up a little bit?

Mr. GUEST. That is right, but there are other very important influences.

Senator ANDERSON. Oh, yes?

Mr. GUEST. The marked improvement in mortality and the marked improvement in the earnings.

Senator ANDERSON. There is no question of that. There has been the impression left if we didn't pass the Mills bill and happened to go to the 1942 tax, that these companies would just have to slash everything in their dividends, but that hasn't been the experience in the last 10 years.

Mr. GUEST. In my testimony here, I state, and I state positively, that if the 1950 tax were in use this year——

Senator ANDERSON. I didn't mention the 1950 tax.

Mr. GUEST. The 1942 tax bill would increase our tax liability about $2¼ million, and that, in relation to our dividends, would be about 7 or 8 percent, and, with the margin as close as we have in our distribution at the present time, that would require very serious consideration as to whether there would be a dividend vote for a reduction of dividends next year. If it were the 1950 law, there would be no question about it but that we would have to cut the dividends next year. With the other, it would be a matter of judgment of the officials on the board as to whether or not it would be applied. It would be very serious. It would have to be given serious consideration.

Senator BENNETT. May I ask a question at this same point? If the 1942 law were to become permanent, or rates comparable to the 1942 law, would you think that would require some permanent readjustment of your dividend policy? I can understand how you could get by 1 year if you only faced the problem for 1 year, but, if your tax burden were permanent at a rate of approximately 8 per-

cent of your present dividends, do you think that would result in a permanent change in your dividend program?

Mr. GUEST. I will have to give an "iffy" answer to that. If the yields on investments stayed flat, if there were no improvement yields in the next 2 or 3 years——

Senator BENNETT. Let's say all other factors being the same.

Mr. GUEST. There would have to be a cut, yes.

Senator BENNETT. There would have to be a cut. Thank you.

Mr. GUEST. They never are quite the same, of course.

Senator BENNETT. I realize that.

Mr. GUEST. And we have to exercise judgment.

To emphasize the seriousness to the Massachusetts Mutual of the proposal that the 1950 law be applied to our 1958 operations, it appears to us that the resulting tax would be substantially higher than that which would result from any reasonably interpreted use of the regular corporate "total net income" method of taxation.

CONCLUSION

For the above specific reasons and other reasons already presented, we believe that life-insurance companies are already carrying a heavy burden of taxation, and I urge the passage of H. R. 10021 without amendment.

The CHAIRMAN. Thank you very much, indeed. The Chair submits for the record a letter from Senator H. Alexander Smith, with attached statement from The Prudential Insurance Company of America, favoring enactment of H. R. 10021.

(The material referred to follows:)

UNITED STATES SENATE,
COMMITTEE ON LABOR AND PUBLIC WELFARE,
March 4, 1958.

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

DEAR HARRY: I am advised that the Finance Committee is to hold hearings starting Wednesday, March 5, on the bill known as H. R. 10021, which has to do with the taxation imposed on the income of life-insurance companies.

The Prudential Insurance Co., which, as you know, is headquartered in New Jersey, is one of the largest companies in America. After conferring with some of their officials, I have received a letter signed by their general attorney, which indicates the effect of the passage of this bill upon the Prudential Co., with a corresponding effect, of course, on other mutual insurance companies. I am taking the liberty of sending a copy of this letter to every member of the Finance Committee, so they can be familiar with the impact of the tax based on their 1957 business under the different formulas that are before your committee.

Let me emphasize that the Treasury Department has been preparing since 1955 to provide a permanent method for taxing life-insurance companies, but which proposal has not yet been fully developed. Therefore, it has been suggested that H. R. 10021 would carry on for another year the tax which has been in effect for 1955 and 1956 business.

It is my sincere hope that your committee will see fit to report H. R. 10021 favorably.

Always cordially yours,

H. ALEXANDER SMITH.

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA,
Newark, N. J., February 28, 1958.

Hon. H. ALEXANDER SMITH,
United States Senate, Washington, D. C.

MY DEAR SENATOR: We are greatly disturbed at the Prudential, as I am sure they are at other life-insurance companies, by the failure of the Senate Finance Committee to have reported favorably upon H. R. 10021. The purpose of that bill is to apply the tax imposed on the income of life-insurance companies which was in effect for the years 1955 and 1956 to the taxable year 1957. Hence, it is necessary that this bill be passed and become law prior to March 15. The reason for the bill is briefly and succinctly stated in the report of the Committee on Ways and Means (Rept. 1296) attached hereto. As the report points out, the Treasury Department has been preparing since 1955 a proposal to provide a permanent method of taxing life-insurance companies, but has not as yet fully developed it.

It is our understanding that when H. R. 10021 came before the Senate Finance Committee a week ago, it was suddenly proposed that Congress wait no longer for the recommendations of the Treasury, but that a permanent formula be included in H. R. 10021 that would become applicable for the year 1958 and succeeding years, the proposed formula to be the same as that which was in force in the year 1950. The Finance Committee is to hold hearings starting Wednesday, March 5, on this proposal.

It is not our intention at this time to attempt to argue the technical aspects of the 1950 formula or that the tax would be too high, but to plead for simple and orderly justice. The insurance industry has waited patiently for the Treasury proposals, and had been led to believe the tax for the year 1957 would be based on the formula provided by Public Law 429 of the 84th Congress, as extended by H. R. 10021. As a matter of fact, the Prudential, in its year-end statement, set up its Federal tax liability on that basis, as did, we believe, most other life-insurance companies.

If H. R. 10021 does not become law prior to March 15, then the companies would be taxed on a formula contained in the 1942 law, which formula was abandoned in 1948 when it produced practically no income for the Government.

The practical effect of this situation is that the Prudential paid taxes on its business as follows:

1954 (6.5 percent)	$23,400,000
1955 (7.8 percent)	32,300,000
1956 (7.8 percent)	35,100,000

The estimated tax on the 1957 business is as follows:

Under H. R. 10021 (7.8 percent)	$38,500,000
1942 formula (11.62 percent)	57,000,000
1950 formula (15.6 percent)	75,000,000 plus

As you know, the Prudential is a mutual life-insurance company with approximately 46 million policy and certificate holders. The average amount of each policy or certificate is approximately $1,300. Although the assets of the company seem large, $13.9 billion, they represent the savings of the average and under-average income groups. Being a mutual company and, hence, having no stockholders, all taxes, Federal and State, come from the pockets of these millions of small-policy holders.

We firmly believe that, in all fairness, the Senate Finance Committee should report favorably H. R. 10021, so that it can become law by March 15. Any attempt to establish a permanent formula for the taxation of life-insurance companies should be by a separate bill, with adequate time for full hearings and consideration. The very history of life-insurance taxation points up the extreme complexity of the subject.

Any assistance you can provide to bring about this result will be a help to the three-fourths of the families of this country who rely upon life-insurance protection for their family security. It has always been a basic social and economic concept of the American way of life to encourage and foster the desire of the individual to provide for himself and his family against the uncertainties and vicissitudes of life and not to rely on charity and governmental assistance.

With kindest regards.

Sincerely,

RICHARD J. CONGLETON.

The CHAIRMAN. The committee will adjourn until 10 o'clock tomorrow morning.

(Whereupon, at 5 p. m., the committee adjourned to reconvene at 10 a. m., Thursday, March 6, 1958.)

TAXATION ON LIFE INSURANCE INCOME

THURSDAY, MARCH 6, 1958

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

The committee met, pursuant to call, at 10:15 a. m., in room 312, Senate Office Building, Senator Harry Flood Byrd (chairman) presiding.

Present: Senators Byrd, Kerr, Frear, Smathers, Long, Anderson, Douglas, Gore, Martin, Flanders, Malone, Carlson, and Bennett.

Also present: Elizabeth B. Springer, chief clerk.

Senator KERR (presiding). The committee will come to order. I submit for the record a letter I received from Mr. R. T. Stuart, Jr., president of Mid-Continental Life Insurance Co., of Oklahoma City, Okla., who strongly endorses H. R. 10021.

(The letter referred to follows:)

MID-CONTINENT LIFE INSURANCE CO.,
Oklahoma City, February 26, 1958.

Hon. ROBERT S. KERR,
Senate Office Building,
Washington, D. C.

MY DEAR SENATOR: Throughout the years you and Dad maintained a friendship that was mutually helpful. While I would not presume upon that friendship, I do feel that I can write you upon matters of vital concern upon the same basis that he would have written if he were still here.

My wire this morning and this letter are prompted by the information that there has developed serious opposition to HR. 10021 providing for the extension of the 1955 formula for taxing the income of life-insurance companies to the tax year 1957. As you are a member of the Senate Finance Committee, which is to hold public hearings on this matter on March 5, you will have the benefit of the technical matters involved insofar as the life insurance is concerned generally. We are a member of the American Life Convention, and their representations have consistently represented our views. For these reasons I will avoid detailed discussion of the general proposition.

Our primary concern at this time is that at a period when we are contemplating immediate expansion into several other States, we are being faced with a tax problem retroactive in nature, and thus cannot know until some indeterminate time what effect this will have on our plans. In order to plan at all, we have had to assume that our tax for the year 1957 would be on the 1955 formula. You, as a businessman, can appreciate the difficulty of planning your business operations for the future when you are being threatened with an unknown tax liability on a year whose operations should be considered closed.

The Treasury Department has long had the question of a permanent formula for income tax on life-insurance companies under consideration. Simple justice would seem to demand that no formula should apply retroactively; that when a business year has closed with no action having been taken, the company's planning should be permitted to include the anticipation that the last existing formula would apply. Further delay in extending the 1955 formula can only result in our being handicapped in all of our operations. These, of course, include our investment program, which is so vitally needed in today's slipping economy.

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I cannot too strongly urge you to support the immediate extension of the 1955 formula for taxing the income of life-insurance companies to the year 1957.

With kindest regards, I am

Sincerely yours,

R. T. STUART, Jr., *President.*

Senator KERR. Mr. Bradshaw. Will you take a seat, sir?

STATEMENT OF THOMAS A. BRADSHAW, PRESIDENT, PROVIDENT MUTUAL LIFE INSURANCE COMPANY OF PHILADELPHIA

Mr. BRADSHAW. Gentlemen, my name is Thomas A. Bradshaw. If I may I would like to preface the reading of this statement by saying that I have made it brief, as you will see, because I thought that if I amplified it, I would be merely engaging in repetition of a good many of the thoughts that were expressed here yesterday. And, therefore, I have devoted my statement mostly to the effect of these various measures on our own company operations.

The Provident Mutual, as its name implies, is a mutual company owned entirely by its policyholders. At the end of 1957, the life insurance in force in the company totaled $2,102,000,000, consisting of about $1,907,000,000 of individual insurance and about $195,000,000 in group life-insurance coverages.

Parenthetically, I suppose that we would be termed as a medium-sized or a medium-large-sized company, depending on your point of view.

Senator KERR. One of the smaller of the large and one of the larger of the small?

Mr. BRADSHAW. That might be true.

The company's assets as of December 31, 1957, amounted to $810,368,000. Of the total liabilities, some $207,000,000—or slightly over 25 percent—represent obligations for moneys left with the company under settlement options and in the form of accumulated dividends, as distinguished from the insurance reserves.

On the basis of the tax law in effect for 1956, our 1957 Federal income tax would be $2,183,000, as compared with a tax of $2,082,213 in 1956. Under the 1950 law, our tax for 1957 would be $4,272,000, and if the 1942 formula were applied the 1957 tax would be $3,770,000.

Senator ANDERSON. Have you got the basis of those computations? That seems to be quite a bit higher than some of the other companies.

Mr. BRADSHAW. Yes, Senator. I want to assure you that I am not an actuary and I want to draw on my judgment——

Senator ANDERSON. Yes, but you show the tax is nearly double.

Mr. BRADSHAW. Yes. I think it is nearly double. It works out that the 1950 tax——

Senator ANDERSON. I am not talking about 1950 tax, the 1942.

Mr. BRADSHAW. 1942 would be about 49 percent of the tax on the 1956 basis. I have a figure here, let me look at it.

Senator KERR. It would be 49 percent of it, or 49 percent increase?

Mr. BRADSHAW. I think it is a 49 percent increase.

Senator ANDERSON. I wouldn't want to multiply it out with you, but I would hardly concede that. How did you do it?

Mr. BRADSHAW. I divided $3,770,000—that is where I made my mistake, I divided $3,770,000. But anyway, that is the increase, the figure is right.

Senator ANDERSON. Is it?

Mr. BRADSHAW. Yes. You asked me why. I think the answer is this: That our company has, as I pointed out, a great proportion of its assets in settlement options, accumulated dividends, and things of that kind. We have a great proportion of our policies in high reserve policies, the endowment form. Our company traditionally, up to the time of inflation, probably sold more endowments than most companies. So, I do feel that our tax implications are different than you might find in other companies with other content of policies. That is my judgment. But I would prefer to have an actuary give you the right answer. That is the way I look at it.

As a result of our 1957 operations, and assuming a continuation of the 1956 form of taxation, our contingency reserve or surplus increased by $1,068,519 after provision for policyowners dividends. However, if the 1942 law were applied to 1957 operations, our contingency reserve would decrease by about $18,481—and if the 1950 law were applied our contingency reserve would decrease by about $1,020,481.

Senator ANDERSON. There again I have a little trouble with your arithmetic. Your surplus was increased by $1,068,000?

Mr. BRADSHAW. That is right.

Senator KERR. That is, if the 1956 law applies?

Mr. BRADSHAW. Yes.

Senator KERR. If the 1942 law applies, instead of having $1,086,000 increase, you would have an $18,000 decrease?

Mr. BRADSHAW. Yes, that is our actuary's estimate, about $18,500 decrease.

Senator ANDERSON. That is what I am trying to find out, how did you get that? You said previously—and that is the figure that I objected to—that your tax would increase $1,587,000.

Mr. BRADSHAW. I beg your pardon, Senator. I see here that there is a mistranscription. That figure $3,770,000 here ought to be $3,270,000. I beg your pardon. I am glad you caught that. I have got it here on this sheet.

Senator ANDERSON. I objected to the size of it, and you assured me it is right.

Mr. BRADSHAW. I thought it was. I thought it was corrected in the statement. Now I am reading from my source given to me by my actuary, and I see it is $3,270,000 tax on the basis of the 1942 formula.

Senator ANDERSON. I am glad to know you don't have different arithmetic in Philadelphia than we do.

Mr. BRADSHAW. Thank you very much.

Obviously any such result would have a marked effect upon the company's operations and ultimately upon the net of the policyholders' life-insurance savings.

In order that serious and justifiably unexpected results of this nature shall not be imposed on our policyowners, I urge that your committee not approve extension of the 1942 or 1950 laws either for application to 1957 or as permanent legislation. I think it can be fairly demonstrated that through the combined effect of the State premium taxes and the Federal income taxes, the Nation's policyowners are already carrying a heavy burden of taxation on their life-insurance savings.

Gentlemen, if I may, I would like to make one more comment. No, I believe I have finished my comments, and I would be glad to have any questions if you care to ask them.

Senator KERR. Mr. Bradshaw, I want to ask 2 or 3 questions, and then I am sure others will also. The statement is that your company is a mutual company owned entirely by its policyholders?

Mr. BRADSHAW. Yes, sir.

Senator KERR. Your policyholders' interests are in accordance with the terms of their contracts with you, aren't they?

Mr. BRADSHAW. Well, that is true, except that the owners of the company are the policyholders.

Senator KERR. Well, you see, we own America.

Mr. BRADSHAW. That is true.

Senator KERR. But our ownership in it is determined by the provisions of law and the application of law to private property, and the specifics of our type of private property, aren't they?

Mr. BRADSHAW. That is right.

Senator KERR. Now, you say the policyholders own the insurance company, and I don't dispute that. But their ownership of it is as outlined in their contracts with it, which are their policies?

Mr. BRADSHAW. Well, that is true. But you see, in addition to that, in addition to the minimum guaranties of their policies, the whole concept of the mutual insurance business is that you try to provide that insurance at the lowest possible cost. Therefore, when you have surplus that you can prudently distribute, then you prudently distribute that to those policyholders as equitably as we know how to do to reduce the cost of their insurance.

Senator KERR. But that which you don't distribute to them, you still keep?

Mr. BRADSHAW. It remains with the company as a safety fund.

Senator KERR. They don't determine how much is distributed to them?

Mr. BRADSHAW. No; the directors determine that.

Senator KERR. The directors do that?

Mr. BRADSHAW. With this modification that I would like to make, our State law provides that we may not accumulate more than 10 percent surplus.

Senator KERR. More than 10 percent of what?

Mr. BRADSHAW. 10 percent of liabilities. Now, obviously, the reason for that in a mutual company is so that there will be a reasonable measure not to overaccumulate surplus, so that it will return to the owners of the company, namely, the policyholders.

Senator KERR. Now, at the end of 1957, you had $2,102 million of assets?

Mr. BRADSHAW. No, sir. We had that much life-insurance risk in force.

Senator KERR. What were your assets?

Mr. BRADSHAW. $810,368,000.

Senator KERR. You had $810 million at the end of 1957?

Mr. BRADSHAW. That is right.

Senator KERR. What was it at the end of 1956?

Mr. BRADSHAW. At the end of 1956, the assets were $796,680,000.

Senator KERR. What were they at the end of 1950?

Mr. BRADSHAW. At the end of 1950, Senator, I could only take a guess. I don't have the information. If it will touch on the point you are driving at, I can give you 1947. They were $569,800,000.

Senator KERR. $569 million?

Mr. BRADSHAW. Yes.

Senator KERR. Now, you had lots of policyholders in 1947 that you didn't have at the end of 1956; don't you?

Mr. BRADSHAW. Yes, sir,

Senator KERR. Now, the policyholders you had in 1947 were the owners of that $569 million assets; weren't they?

Mr. BRADSHAW. Yes, if you have the concept of liquidating the company, there isn't any question about that.

Senator KERR. I don't have that concept. We are just taking your statements.

Mr. BRADSHAW. That is right.

Senator KERR. If your policyholders own it today, they owned it in 1947.

Mr. BRADSHAW. That is right.

Senator KERR. But they were a different set of policyholders; is that right?

Mr. BRADSHAW. To a great degree; yes, because of changes.

Senator KERR. What became of the interests of the policyholders that you had in 1947?

Mr. BRADSHAW. Well ——

Senator KERR. Now, do you know what my question is?

Mr. BRADSHAW. I thought I anticipated, but I will quit.

Senator KERR. If you can reard my mind, I am going to leave.

Mr. BRADSHAW. I beg your pardon.

Senator KERR. Let's go back to the premise that your policyholders in 1947 owned $569 million worth of assets of the company.

Mr. BRADSHAW. Yes, sir.

Senator KERR. A lot of these people are dead; aren't they?

Mr. BRADSHAW. Yes, sir.

Senator KERR. They are no longer policyholders, are they?

Mr. BRADSHAW. That is right.

Senator KERR. Who inherited the interest that they had in that $569 million that they didn't get?

Mr. BRADSHAW. Of course, there were a lot of them that remained policyholders, and then during the course of their——

Senator KERR. I am talking about the ones that are dead.

Mr. BRADSHAW. All right. During the course of their holding insurance in the company, each year there was distributed to them a part of the divisible surplus of the company and ——

Senator KERR. A part of their assets?

Mr. BRADSHAW. No; I think that on the average you will find that over the course of the lifetime of the policy, there has been distributed through annual dividends what they are entitled to.

Senator KERR. Now, if that is the case, you have always got more left at the end of the year than you had when the year started.

Mr. BRADSHAW. We hope so.

Senator KERR. If they owned it then and then died, who inherited it? Did their children get it?

Mr. BRADSHAW. During the course of their membership in the company, carrying their policies, there was distributed to them each year an equitable part of the surplus that was available.

Now, remember one more thing, Senator ——

Senator KERR. Just a part of that. That was distributed to them in 1947, wasn't it, if they were live policyholders, they got some distribution?

Mr. BRADSHAW. And in 1946, 1945, and other years.

Senator KERR. They owned the company and, $569 million, that is what you said.

Mr. BRADSHAW. They owned that minus some liabilities that were owned in the way of expenses here and there. But actually the part over and above those other liabilities would be somewhat less than the $569 million.

Senator KERR. How much?

Mr. BRADSHAW. Well, honestly, I don't know.

Senator KERR. You have got the figures there ——

Mr. BRADSHAW. No; I have the summaries ——

Senator KERR. Of assets, and no offsetting liabilities.

Mr. BRADSHAW. I have this last year.

Senator KERR. In 1947.

Mr. BRADSHAW. All I have here is a printer's proof of a comparative summary of assets, and so on, drawing the comparison between 1947 and then 1956 and 1957.

Senator KERR. There was some net value there; wasn't there?

Mr. BRADSHAW. Surely.

Senator KERR. Now, I am talking about the fellows who owned that in 1947 and died.

Mr. BRADSHAW. As I say, our method of distributing surpluses on the annual basis——

Senator KERR. Don't filibuster me, just tell me, if they owned it and died, who got their interest in it?

Mr. BRADSHAW. I am not sure that I am a learned enough actuary to say this, but I think that they didn't have any remaining interest in it.

Senator KERR. Then it belongs to part of your policyholders?

Mr. BRADSHAW. I want to point this out——

Senator KERR. You said it belonged to all of your policyholders?

Mr. BRADSHAW. It does, it belongs to the policyholders as a group, it does.

Senator KERR. Now you had these policyholders in 1947?

Mr. BRADSHAW. That is right.

Senator KERR. And they owned it?

Mr. BRADSHAW. Yes.

Senator KERR. And several hundred of them died?

Mr. BRADSHAW. Surely.

Senator KERR. Who inherited their interest in it?

Mr. BRADSHAW. In the surplus?

Senator KERR. Yes.

Mr. BRADSHAW. Certainly they did not, those individuals, did not, that is right, inherit the remaining surplus.

Senator KERR. Their children didn't? Did their children inherit it?

Mr. BRADSHAW. No.

Senator KERR. Then they didn't own it, because under our law, when a man owns something and dies, it descends, under our law of descent and distribution, to somebody; doesn't it?

Mr. BRADSHAW. Yes; that is correct.

Senator KERR. Then if nothing descended, nothing was owned?

Mr. BRADSHAW. I still insist, though, that the aggregate body of policyholders owns the company. I think I could illustrate to you, if the unhappy day should come, at least in my opinion, when the company were liquidated, that the policyholders would be the only people entitled to it.

Senator KERR. You are not going to do that?

Mr. BRADSHAW. Certainly not. But I think that is an illustration of it.

Senator KERR. The point is that they own something which is intangible, if they own something that they can't will, they can't transfer, they can't possess, isn't it a rather remote ownership, Mr. Bradshaw?

Mr. BRADSHAW. Well, that depends on your terms, I think. It is remote in the sense of your saying an individual has a piece of inheritable property, certainly, it is.

Senator KERR. If it is his, it is inherited?

Mr. BRADSHAW. But I say the aggregate of the policyholders——

Senator KERR. But if it is his, it is inherited. I don't know much about some things, but I know a lot about that. Do you agree with me, if it is his, it is inheritable?

Mr. BRADSHAW. I am saying, though, that the aggregate of the policyholders own the assets of the company minus what obligations are owing to someone else. And I would just like to point this one thing out while we are on the point, which, although it is germane, I believe, is not directly to your point. When a policyholder becomes a policyholder, he has immediately the protection of the surplus there.

Senator KERR. But that is set out in his contract.

Mr. BRADSHAW. No.

Senator KERR. He has the protection, all he can get is what his contract specifies.

Mr. BRADSHAW. Of course. But when he first becomes insured in the company, let's say he has paid a premium of $50, and the company, if he dies tomorrow, is obligated to pay X dollars.

Senator KERR. But that is because of his contract.

Mr. BRADSHAW. Of course it is.

Senator KERR. And only because of his contract.

Mr. BRADSHAW. But one of the reasons that that is possible is that when he entered, there was a surplus that had already been created——

Senator KERR. You mean the only reason that it is possible is that you were able to live up to your agreement?

Mr. BRADSHAW. Yes.

Senator KERR. Bu that is all you do?

Mr. BRADSHAW. But one of your reasons is that you have that surplus, it is there when a man enters——

Senator KERR. Who has that surplus?

Mr. BRADSHAW. The company.

Senator KERR. That is right.

Mr. BRADSHAW. The policyholders who own the company.

Senator KERR. That policyholder doesn't have that surplus.

Mr. BRADSHAW. He doesn't have that, but he entered the company for the protection of part of it.

Senator KERR. He entered the company on the basis of his contract; didn't he?

Mr. BRADSHAW. Yes, sir.

Senator KERR. And that is all he gets is what his contract specifies; isn't it?

Mr. BRADSHAW. Plus his share of distributable surplus year by year.

Senator KERR. But that is in the contract?

Mr. BRADSHAW. It is in the contract, but the amount is undetermined

Senator KERR. But you specify in that contract he is going to participate in the dividend, the distributable surplus?

Mr. BRADSHAW. That is quite right.

Senator KERR. But he doesn't determine what is distributable?

Mr. BRADSHAW. Of course not, the directors do.

Senator KERR. The directors do.

Mr. BRADSHAW. Subject to the limitations of law that I am telling about.

Senator KERR. Sure, it is assumed that we all operate subject to the limitations of law. You can indulge that presumption with reference to this committee.

Mr. BRADSHAW. Of course that is right. But I did want to point out that the law provides for a surplus or safety fund for the safety of the policyholders, but limits how high it can go.

Senator KERR. But it doesn't say that you have got to distribute it all.

Mr. BRADSHAW. Of course not. The law itself would permit us to maintain a 10-percent fund.

Senator KERR. That is 10 percent of the insurance in force?

Mr. BRADSHAW. No; of liabilities.

Senator KERR. Whatever you set up as a liability on the basis of what insurance you have in force indicates what it will be?

Mr. BRADSHAW. That would influence the reserves behind policies, the amounts held under settlement options, under accumulated dividends, and things of that kind, annuities, and so forth.

Senator KERR. As far as I am concerned, Mr. Bradshaw, I don't believe that the Provident Mutual is a mutual company owned entirely by its policyholders. I don't believe that statement. I have never seen a witness that could establish the accuracy of that statement.

Mr. BRADSHAW. I believe it is true, sir. That is my opinion.

Senator KERR. Well, you can indulge that fantasy if you want to, and impose it upon others who don't know any better than to accept it.

Senator LONG. Might I ask a question at that point?

Mr. BRADSHAW. Yes, sir.

Senator LONG. Who controls that company?

Senator KERR. He said the directors.

Mr. BRADSHAW. You see, there are no stockholders. The policyholders are members.

Senator LONG. You say the policyholders own it, but they don't control it. Can they control it?

Mr. BRADSHAW. They can.

Senator LONG. How?

Mr. BRADSHAW. By voting in a new set of directors.

Senator KERR. By launching a proxy fight and getting a new set of directors.

Mr. BRADSHAW. That is right.

Senator ANDERSON. Do they vote?

Mr. BRADSHAW. They don't vote in great numbers.

Senator KERR. They could.

Senator ANDERSON. Do they vote at all?

Mr. BRADSHAW. Yes.

Senator ANDERSON. I am a policyholder of Mutual of New York, New York Life and Equitable. Has anybody ever asked me to vote?

Mr. BRADSHAW. I don't know. We send notices to our policyholders.

Senator KERR. If you belonged to the Provident Mutual of Philadelphia, you would.

Mr. BRADSHAW. We invite them to the meetings, but they don't show up very much.

Senator LONG. If they want to engage in a proxy fight with you, do they give you notice that they want to elect new directors? I know that some State laws require that.

Mr. BRADSHAW. My recollection is that a nomination for director must be on file by the 15th of December, and our annual meeting takes place, I believe, the first Monday in February—I ought to know, it happened a little while ago. And I believe any five policyholders may make a nomination for directors.

Now, the directors are elected in classes. There are 15 directors, for 3-year terms, 15 each year.

Senator LONG. They have got to give you 45 days' notice that they want to run against you?

Mr. BRADSHAW. That is right. And we have to have what you might call our "slate" filed at the same time.

Senator ANDERSON. You are the president of the company and don't recall when the annual meeting was? It must have been a significant day in the life of the company, wasn't it.

Mr. BRADSHAW. I do. It was February 10, 1958. I could have said February 11, I was speaking from memory.

Senator MARTIN. I wonder if I might ask a question at this point? When was your company organized?

Mr. BRADSHAW. In 1865, Senator.

Senator MARTIN. We are not expecting it, but suppose it would be necessary to liquidate this company, would a policyholder of 1865, would he participate in that liquidation?

Mr. BRADSHAW. No; I don't believe he would.

Senator KERR. There wouldn't be anybody except the policyholders at the time?

Mr. BRADSHAW. I would think the current policyholders would.

Senator KERR. They would have a bonanza, wouldn't they?

Mr. BRADSHAW. Well, it would be at least some extra dollars that would otherwise be retained in surplus.

Senator KERR. But as the Senator from Pennsylvania has indicated, it was his opinion that all of the thousands of policyholders that your company has had since its organization, and who in their lifetime owned this company——

Mr. BRADSHAW. As an aggregate, I still say that.

Senator KERR. Well, now, did they or didn't they own the company?

Mr. BRADSHAW. As an aggregate, I believe they did.

Senator KERR. You know aggregate can mean anything from truckloads of gravel and limestone to—you said the policyholders owned the company?

Mr. BRADSHAW. Yes, sir.

Senator KERR. Now, let's look at your statement and see if the word "aggregate" is in there.

The Provident Mutual, as its name implies, is a mutual company owned entirely by its policyholders.

Mr. BRADSHAW. Yes, sir.

Senator KERR. Now, is that accurate?

Mr. BRADSHAW. I think it is.

Senator KERR. Where is the word "aggregate" in there, sir?

Mr. BRADSHAW. It is not in there.

Senator MARTIN. A policyholder of 1865, he wouldn't be a part of the liquidation?

Mr. BRADSHAW. No, sir; I don't believe so.

Senator MARTIN. It wouldn't be anybody except the present policyholders?

Mr. BRADSHAW. I have never taken a company through a liquidation, I am only telling you my opinion.

Senator ANDERSON. There is no liquidation unless the assets disappear?

Senator MARTIN. Unfortunately we have had life insurance and fire insurance companies liquidated, that has happened many times in America.

Mr. BRADSHAW. That is only my opinion, Senator. It would be my opinion, however, that if all the policyholders, or a sufficient number, should decide to say, "Let's call the whole deal off," I would say then, it would be the present policyholders who would share in the assets according to their relative positions.

Senator LONG. Let me ask you, have any insurgents since 1868 ever successfully ganged up upon the directors to impose a director upon them against their will?

Mr. BRADSHAW. None to my knowledge.

Senator LONG. Do you know of any mutual company of any size where that has ever happened?

Mr. BRADSHAW. I don't personally.

Senator KERR. Let's say that they did, and that they elected their own set of directors.

Mr. BRADSHAW. Then they would probably fire me.

Senator KERR. No, I am quite serious about it. What else could they do besides elect the directors?

Mr. BRADSHAW. Well, the directors——

Senator KERR. I say, what else could the policyholders do?

Mr. BRADSHAW. I don't believe they would do anything much except, as you would find in most any corporation——

Senator KERR. I say, what else could they do?

Mr. BRADSHAW. If they didn't like the way the directors operated the company, then they could decide to get some more directors.

Senator KERR. But the extent of their ownership, even if they exercised it, is to elect a new set of directors; is that it?

Mr. BRADSHAW. I believe that is true. And I suppose there would be all kinds of instances, just as in a general stock corporation, where when particular things come up, the stockholders could take direct action, I suppose policyholders could, in case of particular abuses.

Senator KERR. You suppose they could if they owned it. I want to assure you they could.

Mr. BRADSHAW. I was just going to say, let's take the telephone company, for example. Normally the directors run the company; don't they? And the stockholders as such don't do anything but elect the directors. But there could be kinds of situations arise where stockholders might take direct action of some kind or another, I would assume.

Senator KERR. How do you change the bylaws of your company?

Mr. BRADSHAW. The bylaws themselves say that they may be changed by the board after passing a certain meeting.

Senator KERR. By the board?

Mr. BRADSHAW. Where there are changes such as the date of annual meeting, things of that nature, we customarily send notice to the policyholders to have it approved at the next annual meeting.

Senator KERR. You would hate to have to feed your family on the basis of your ownership as a policyholder beyond the provisions of yours contract; wouldn't you?

Mr. BRADSHAW. Well, I suppose you are right, sir.

Senator KERR. All right, let's just leave it right there, and let's go to the last page of your statement.

In order that serious and justifiably unexpected results of this nature shall not be imposed upon our policyholders, I urge that your committee not approve extension of the 1942 or 1950 laws either for application to 1957 or as permanent legislation.

Don't you know that the 1942 law is now in effect and has been since January 1, 1957?

Mr. BRADSHAW. Yes, I know that.

Senator KERR. Whether we urge the extension of it or approve the extension of it or not?

Mr. BRADSHAW. I will be willing to change that word in any way that is suitable.

Senator KERR. I just want to see if you and I understand the situation differently.

Mr. BRADSHAW. No, we understand each other, I think, on that one.

Senator KERR. Well, then, the 1942 law is in effect and has been since January 1, 1957.

Mr. BRADSHAW. Unless the Congress chooses to——

Senator KERR. Unless the Congress chooses to change it——

Mr. BRADSHAW. Supplant it by something else.

Senator KERR. It has been in effect all that time, and stays in effect until Congress changes it.

Mr. BRADSHAW. In effect in one sense, and not in effect in another.

Senator KERR. What other sense is it not in effect in?

Mr. BRADSHAW. You said a minute ago that it had been in effect all that time.

Senator KERR. In 1957?

Mr. BRADSHAW. That is right.

Senator KERR. In what regard has it not been in effect since January 1, 1957?

Mr. BRADSHAW. I agree with you, it has been in effect.

Senator KERR. You said it had been in one respect and not in another.

Mr. BRADSHAW. I misunderstood you, Senator, I thought you said it had been in effect all the time since 1942. It has been in effect since 1957 and is now.

Senator KERR. I agree with you now.

The CHAIRMAN (now presiding). Wasn't it set aside? The stopgap was passed in 1957.

Senator KERR. The stopgap that we passed in 1957 applied only to 1956, and did not disturb the effectiveness of it as of January 1, 1957.

Mr. BRADSHAW. Failing affirmative action, the 1942 law would apply to 1957 taxes.

Senator KERR. Does apply?

Mr. BRADSHAW. I say, failing action it does.

Senator GORE. You owe taxes on your income for 1957; don't you?

Mr. BRADSHAW. That is right.

Senator GORE. That has accrued; hasn't it?

Mr. BRADSHAW. Yes, sir.

Senator GORE. And you owe it?

Mr. BRADSHAW. Yes, sir.

Senator GORE. By terms of what law do you owe it?

Mr. BRADSHAW. Well, that is up to Congress.

Senator GORE. No, it is not up to Congress.

Mr. BRADSHAW. If Congress takes no action, then we owe it by——

Senator GORE. Leave out the "if." You say your tax has accrued, your liability has accrued?

Mr. BRADSHAW. That is right.

Senator GORE. And you owe it?

Mr. BRADSHAW. That is right.

Senator GORE. But by terms of what law has your liability already been determined?

Mr. BRADSHAW. Well, I know what you say, and I agree with you, as a matter of law, since the 1942 law——

Senator GORE. Then why do you keep beating around the bush all the time? You keep saying if Congress doesn't take affirmative action. Your taxes are accrued and owed for 1957, and now you are asking Congress to enact a bill for a tax forgiveness for a portion of what you owe for 1957 taxes.

Mr. BRADSHAW. Well, tax forgiveness is one way of saying it. Of course, I personally would say it in a different way.

Senator GORE. Let's find how we can say it. Someone called it "retroactive tax reduction," and no one liked that term. I suggested "tax forgiveness," and you don't like that term?

Mr. BRADSHAW. It doesn't happen to be a term I like, but of course——

Senator ANDERSON. What do you like?

Mr. BRADSHAW. I would prefer to say a review of the thing and your reinstatement of it.

Senator GORE. That is what I would like.

Senator ANDERSON. Did you file a statement for your company?

Mr. BRADSHAW. Yes, sir. And we filed it on the basis of the Mills bill.

Senator ANDERSON. Did you know the oath that you took?
Mr. BRADSHAW. Yes, sir.
Senator ANDERSON. What did you say in that oath?
Mr. BRADSHAW. To the best of my knowledge that it was a true statement.
Senator ANDERSON. Did you think it was? You knew you were under the 1942 act. By your own statement here, you misstated your liabilities over a million dollars. Did you think that was an accurate statement?
Mr. BRADSHAW. I will tell you, Senator, you have to use some judgment in making decisions.
Senator ANDERSON. When you make a sworn statement, judgment factors don't come in. Did you misjudge your cash?
Mr. BRADSHAW. No.
Senator ANDERSON. Did you misstate your mortgages?
Mr. BRADSHAW. No.
Senator ANDERSON. Did you misstate your bonds?
Mr. BRADSHAW. No.
Senator ANDERSON. You just misstated your taxes. Was that a question of judgment?
Mr. BRADSHAW. I believe it was, Senator.
Senator ANDERSON. You swore that these were the actual figures to the best of your knowledge, a true statement of all the assets and liabilities as of the 31st day of December last?
Mr. BRADSHAW. That is right.
Senator ANDERSON. Were they?
Mr. BRADSHAW. It depends on what the Congress does.
Senator ANDERSON. No, it doesn't—it may subsequently become that, but at the time you filed this statement it wasn't, was it?
Mr. BRADSHAW. Not from your point of view, of course.
Senator ANDERSON. Why do you say it that way? You filed this statement on the 28th day of February, didn't you?
Mr. BRADSHAW. I believe that is right; yes.
Senator ANDERSON. Now, as of that time the law is the 1942 law; isn't it?
Mr. BRADSHAW. That is correct.
Senator ANDERSON. And therefore if you on that date filed a statement saying that is what you owed on the 31st day of last December, you misstated it by a little over a million dollars, didn't you?
Mr. BRADSHAW. I sure did, if that is the way the law remains.
Senator ANDERSON. The way the law remains? No, that is a prediction of circumstances. Your statement reads, "In order that serious and unjustifiably unexpected results . . ." You mean it is unexpected if you have to live under the law?
Mr. BRADSHAW. No, sir. But if you will bear with me a minute, at the time that these figures had to be put together, at least my best information was that the House had passed a reenactment of the Mills bill for 1957, and that the Treasury had announced that it was willing that that be done. As a matter of judgment, I think it was a very reasonable speculation that that was our tax liability.
Senator ANDERSON. You thought that as soon as the Treasury announced that was to be done that the Senate would just jump up through the hoop?

Mr. BRADSHAW. No.

Senator ANDERSON. Why didn't you stay with the law?

Mr. BRADSHAW. Because I thought that was a reasonable business decision to make.

Senator ANDERSON. Your oath doesn't say anything about a reasonable business decision. It says that, being duly sworn, you testified that what you have in this report is "a full and true statement of all the assets and liabilities, and of the conditions of said insurer on the 31st day of December last, and its income and deductions therefrom for the year ended on that date, according to the best of their information, knowledge, and belief, respectively?"

Mr. BRADSHAW. That is right.

Senator ANDERSON. You know what the law was?

Mr. BRADSHAW. I knew what the law was unless it were changed.

Senator ANDERSON. You knew what the law was?

Mr. BRADSHAW. Yes.

Senator ANDERSON. And therefore you misstated the situation by your own figures here over a million dollars?

Mr. BRADSHAW. If that is the way you want to put it, you are right.

Senator ANDERSON. That is the only way you can put it, the law hadn't been changed, had it?

Mr. BRADSHAW. I prefer to look at it a little differently.

Senator ANDERSON. You preferred to look at it so that the life companies would have $124 million?

Mr. BRADSHAW. I thought it was reasonable, I really did.

Senator ANDERSON. The chairman of this committee has advocated for a long time a consolidated budget, and I have been delighted to join with him on it. I think it is a fine idea. It has passed the Senate I don't know how many times—how many times, Mr. Chairman?

The CHAIRMAN. Three times.

Senator ANDERSON. And should we think it was going to be actually enacted into law because it got through the Senate?

Mr. BRADSHAW. No, I suppose legislative history would make me think twice about that.

Senator ANDERSON. It makes me think, also. The budget bill will get through the Senate all right, but not through the House. And this Mills bill may run into a little of the same difficulty. The fact that the insurance companies assume that they will be able to lobby through this legislation and reduce their tax bill by $124 million and not even give the Senate a chance at it before they filed a statement that their taxes had been reduced by the Mills bill is remarkable to me.

Mr. BRADSHAW. Well, I can only repeat as a matter of business judgment I thought it was reasonable.

Senator ANDERSON. You thought everything was in good shape?

Mr. BRADSHAW. I never am that optimistic, but the legislative history here seemed to be reasonable.

Senator ANDERSON. The legislative history would show that when it came up the last time in June 1956, everyone believed that was the last time, that was for the year 1956, and nobody seemed to want to take it up during the year 1957, when attempts were made to persuade Mr. Mills to introduce it, he declined. So I would think the legislative history is out of practice a little bit.

Br. BRADSHAW. Well, I have given you as straight an answer as I know how to do, Senator. That is the way I feel about it. What is your pleasure, sir?

The CHAIRMAN. Have you completed your statement?

Mr. BRADSHAW. Yes, I have.

The CHAIRMAN. Are there any further questions?

Senator CARLSON. I wish to state that I can appreciate Mr. Bradshaw's problem, and I think it was brought out yesterday that we had at least one insurance company testify that they did file on the basis of 1942, which was probably a correct assumption, but there were some features on the other side of it, and I am hoping that we as a committee don't have to go through this again, this is not our first experience, and I hope you folks don't have to go through with it again, because it is a problem for you as well.

Mr. BRADSHAW. I quite agree with you, it is something I would like to get settled.

The CHAIRMAN. The next witness is Mr. Millard Bartels, chairman, insurance executive committee and general counsel, the Travelers Insurance Co.

STATEMENT OF MILLARD BARTELS, CHAIRMAN, INSURANCE EXECUTIVE COMMITTEE AND GENERAL COUNSEL, THE TRAVELERS INSURANCE CO., HARTFORD, CONN.

Mr. BARTELS. Gentlemen, my name is Millard Bartels. I am chairman of the insurance executive committee and general counsel of the Travelers Insurance Company of Hartford, Conn. I am appearing on behalf of my company.

I might say that the purpose of this statement is to illustrate the application of the 1942 formula and the 1950 formula to the operating results of my company for the year 1957.

In 1957, with written premiums of $748,836,000 and gross investment income of $102,470,000 the Travelers Insurance Co. had remaining from the year's operations $22,937,000. Out of such $22,937,000 we reserved $13,377,000 for Federal income tax, computed on the Mills method. This left a net remainder from operations of $9,560,000 before dividends to stockholders. If the 1942 law were to apply, our 1957 Federal income tax would be $17,105,000 and the net remainder to the company would be $5,832,000. Under the 1950 stopgap, our 1957 Federal income tax would be $20,411,000 and the net remainder to the company would be only $2,526,000.

There was a decrease for the year 1957 of $9,483,000 in our surplus to policyholders and of $1,165,000 in our security valuation reserve. If we were required to pay $3,728,000 additional tax under the 1942 formula, the decrease for the year in our surplus to policyholders would be $13,211,000. Correspondingly, if we were required to pay $7,034,000 additional tax under the 1950 stopgap, the decrease in our surplus to policyholders would be $16,517,000.

My company urges your committee to approve the legislation enacted by the House to settle our 1957 tax liability in accordance with the Mills bill. For the reasons which have been stated, we are strongly opposed to the 1942 formula or the 1950 stopgap formula as permanent legislation.

The CHAIRMAN. Are there any questions?

Senator KERR. Mr. Bartels, is Travelers a stock company?

Mr. BARTELS. Yes, sir.

Senator KERR. Do you have a statement there as of December 31, 1957, with you?

Mr. BARTELS. I have an abbreviated one with me, yes.

Senator KERR. May I see one?

Mr. BARTELS. I have to give you two, Senator. One is for our life department and one is for our accident department. We make two statements.

Senator GORE. Do you have additional copies of this?

Mr. BARTELS. No, sir, I do not. I will be glad to furnish them if you would like to have them.

Senator KERR. Where did your losses occur, in the life department or the accident department?

Mr. BARTELS. In the accident department.

Senator KERR. Where was the major portion of your premium income?

Mr. BARTELS. I believe out of the roughly $750 million premium income, $450 million was accident department and $300 million, life. That is approximately the figure in each case.

Senator KERR. What was the results of the year's operation profitwise from the life department?

Mr. BARTELS. I believe the net gain shown on that statement is $23 million.

Senator KERR. Do you show that on this statement?

Mr. BARTELS. Yes. It is over here [indicating].

Senator KERR. That is after dividends to policyholders and excluding capital gains and losses?

Mr. BARTELS. Yes.

Senator KERR. Now, what was the dividend to policyholders?

Mr. BARTELS. Well, they didn't amount to much because we don't write participating business. I don't know what it shows there, but they shouldn't be very much.

Senator KERR. What were dividends to stockholders?

Mr. BARTELS. Dividends to stockholders totaled $11 million in 1957.

Senator KERR. Was that taken out of the $23 million, or was the $23 million left after that?

Mr. BARTELS. That is why I gave you the consolidated figure which showed that $22.9 million was our consolidated net, from which we took on a reserve basis $13 million of tax, leaving $9.5 million, and then we had to take our dividends out of the $9.5 million, and of course we had to dip a little into surplus to do it.

Senator KERR. Now, this says excluding capital gains and losses, do you have a statement of the capital gains and losses?

Mr. BARTELS. I suppose it is in there, but I am not sure I could show it to you. It is a very complicated document, as you know.

Senator KERR. I understand. And can you give me an indication of the net result of it?

Mr. BARTELS. I don't believe the capital gains or losses amounted to much. In one statement maybe they were $2 million gain, I think maybe in that one, and in the other one maybe a small loss. I am not sure, but it isn't a very important factor, I am pretty sure of that.

Senator KERR. Your accident department is a department of the same corporation, I mean the same stockholders own both departments?

Mr. BARTELS. Yes, it is a housekeeping method.

Senator KERR. Now the accident department is accident, health, personal liability and workman's compensation?

Mr. BARTELS. Yes.

Senator KERR. I take it that the net result of that was a loss factor?

Mr. BARTELS. Yes.

Senator KERR. Now your fire and casualty?

Mr. BARTELS. No, that is a separate corporation. That is a property insurance company.

Senator KERR. Is it wholly by this corporation?

Mr. BARTELS. Yes. Our parent company insures persons, all kinds of insurances pertaining to the person. Our principal subsidiary, the Travelers Indemnity Co., insures property insurance.

Senator KERR. Is that fire and casualty?

Mr. BARTELS. That is fire and casualty.

Senator KERR. What was the result of its operation?

Mr. BARTELS. It had an underwriting loss for the year too, not a very large one, a million and a half dollars, I think.

Senator KERR. I believe that is all, Mr. Chairman.

The CHAIRMAN. Are there any further questions?

Mr. BARTELS. Could I introduce one gentleman that I would like very much to hear from this morning, because yesterday, gentlemen, there was a good deal of talk about retroactivity; it caused us a good deal of thought, and we have put together some thoughts on this issue called "retroactivity."

And since I was not personally connected with some of these issues in the past, I would appreciate it very much if you would listen to Mr. Thoré, who was introduced to you yesterday, and who has put together these particular comments on that issue, and I think you should hear them if you would.

The CHAIRMAN. Perhaps it would be well to complete the witnesses that are listed first.

Senator KERR. Are Mr. Thoré's remarks addressed to what Mr. Bartels has told us?

Mr. BARTELS. They are, in effect, because we are all talking about this same thing, and one thing is this 1957 tax and how it should be computed and why. For example, we have reserved on the Mills basis as against the 1942 law. This is very pertinent to that issue.

The CHAIRMAN. That is the same issue?

Mr. BARTELS. Yes.

The CHAIRMAN. So I would suggest, Mr. Thoré, that you testify at the end of the list.

The next witness is from Tennessee, and perhaps our distinguished Senator from Tennessee, Mr. Gore, would introduce him.

Senator GORE. Mr. Chairman, before introducing my distinguished constituent, I would like to suggest for the consideration of the chairman that since members of the committee have been examining the financial statement of the particular companies appearing, it might be advisable to direct the staff to wire all insurance companies to submit their financial statement for 1957. Obviously we are hearing from the

companies that, in the opinion of the industry, present the strongest case for passage of this bill. We would get a more objective view if we had the financial statements of all the companies.

The CHAIRMAN. The Senator from Tennessee recognizes, I assume, that there are 1,200 companies.

Senator GORE. Yes, I do.

The CHAIRMAN. And if we delayed the consideration of this legislation until they were received, the March 15 limit would be exceeded. I don't imagine you could get this information in less than 2 or 3 weeks.

Senator LONG. Would it be possible to go by size, Mr. Chairman? It occurs to me that out of 1,200 companies probably about 200 of them would have the bulk of the business. As in most general business structures the large ones tend to have about 80 percent of the business and the small ones the rest.

Senator GORE. Mr. Chairman, I don't think that I would concede that it would take 2 or 3 weeks to get the financial statements. All companies are required to publish their financial statements, and a wire ought to bring from each company certainly by Monday by air-mail, a copy of its financial statement. I recognize that it will take some time to examine this problem, but it does seem to me that we would be unwise to proceed to act only upon the testimony presented here by the insurance industry. We need to give it objective consideration.

Senator CARLSON. Speaking on the thought of the Senator from Tennessee, I would realize the importance of getting those statements, and I think we need it when we start writing permanent legislation, and I would be happy to have it if we had time. But it is only a matter of 9 days, that this has got to be passed through the Senate, and if we make some amendment it has got to be accepted by the House and get some credit, or these people pay on the 1942 rate. I think in view of that, as the Senator from Louisiana suggests, if we had a few examples, instead of them all, would be enough. I think it would clutter up the record to get them all.

Senator KERR. If the Treasury has this income, or its staff could make an accurate estimate of it, and then let us have access to it, I would suppose that for the purposes of consideration of this measure that we could rely on the Treasury for the information. I believe we could do what would amount to elimination of the possibility of action affirmatively on the bill to interject the procedure that has developed, if that were done.

Senator GORE. Well, for instance, Mr. Chairman, it is only by receipt of a letter from our distinguished colleague, the senior Senator from New Jersey, that we know that the Prudential Life is asking forgiveness of some $17 million. We don't have the financial statement of the company. There is no way that I can determine whether it would be equitable, whether they need it.

How can I vote for a bill to forgive one concern $17 million in taxes already owed unless I have a chance to examine its financial statement and determine whether or not the tax imposes a hardship? We are asked to leap into the dark here on a very important question.

The CHAIRMAN. When I said 2 weeks, I meant of course the consideration and examination of these returns by the committee, in addition to the time consumed in the beginning of this.

Senator GORE. Unless we have time to consider the legislation, then we surely ought not to pass it.

Senator LONG. What I am suggesting, Mr. Chairman, is that we ask the 50 largest companies to submit their return. We could get a pretty good sample, and if we want a cross section of the others, the Treasury could go across and make a cross section of the others to see what the situation is. That way I think dollarwise we could see what is the tax impact for the most part by looking at the large ones. As far as the smaller ones are concerned you could take some sampling to show that.

Senator GORE. Really the only suggestions we have had as to the reason why this bill should be passed is that it creates some inequity. Well, it probably creates some windfalls too. I can think of nothing more inequitable in our tax system than allowing a taxpayer a deduction of only $600 for a dependent. There are many inequities in our tax law. And I don't want to vote for a bill to give a lot of windfalls without knowing who is going to get them and whether they are justified.

Shall I leave this to the decision of the chairman?

The CHAIRMAN. I would like to make that decision, because I think it means unquestionably, if an examination is to be conducted of 1,200 returns or statements and the time consumed in getting them here and considering them, I think then the date will be passed——

Senator LONG. Mr. Chairman, I would like to move that we request the largest 50 to let us have their financial returns, and request the Treasury to submit us insofar as they can a statement of the extreme hardship cases among the smaller companies. I think that that might be practical.

Senator KERR. Would the Senator yield?

Senator LONG. Yes.

Senator KERR. Does he think that the committee, with only six members here at this time, should act on the motion? If the Senator wants to make the motion, doesn't he feel that we should see after we have completed the hearings with the witnesses that are here and go into executive session?

Senator LONG. I am going to accommodate myself to the wishes of the chairman or the majority of the committee in either event.

Senator KERR. I would have to object to the absence of a quorum.

The CHAIRMAN. The Senator from Tennessee knows that I have always been in favor of getting the utmost information, but we are working against a deadline that we must meet or the legislation remains on the books. In view of that it seems to me it would be impossible for us to attempt to examine the 1,200 returns. I think the Treasury, as the Senator from Oklahoma said, would have a great deal of this information available, upon request.

Senator GORE. But upon the available information, they pointedly refused to make a recommendation yesterday.

Senator CARLSON. If the Senator from Louisiana would withdraw that until the chairman confers with the Treasury, let us see what we can get on that from the Treasury.

The CHAIRMAN. I wouldn't feel justified in making a decision myself. But I will confer with the Treasury and see.

Senator GORE. Mr. Chairman, I take pleasure and pride in introducing to the committee a distinguished Tennesseean who is my per-

sonal friend of many years standing, whose business acumen and success is excelled only by his civic and patriotic accomplishments. Mr. Cecil Woods, president of the Volunteer State Life Insurance Co.

STATEMENT OF CECIL WOODS, PRESIDENT, VOLUNTEER STATE LIFE INSURANCE CO., OF CHATTANOOGA, TENN.

The CHAIRMAN. Mr. Woods, we are very happy to have you. You may proceed.

Mr. WOODS. Mr. Chairman and gentlemen of the committee, I must precede any formal remarks by saying that I am deeply grateful to the Senator from Tennessee for those very kind words that, while undeserved, are deeply appreciated, because I don't know whether you gentlemen have enjoyed the last 24 or 30 hours, but speaking for myself, I have not.

I am sorry this situation exists that causes a hearing of this kind under the conditions of pressure, when this situation so demands and deserves more time.

Senator KERR. You have been available at all times to testify, had the matter been before the committee, and you have been advised of the opportunity to testify, haven't you?

Mr. WOODS. Yes, sir.

Senator KERR. I mean, any delay in our getting around to this is not entirely your fault.

Mr. WOODS. Thank you very much.

Mr. Chairman and members of the committee, my name is Cecil Woods, and I am president of the Volunteer State Life Insurance Co., of Chattanooga, Tenn. Our company is 55 years old and had, on December 31, 1957, assets of $68,153,180. Its capital and surplus, including contingency reserves, amounted to $7,240,934.

As you can see, this places us in a position where our assets and capital structure are somewhat representative of a very large number of life-insurance companies in the United States. As of the last figures available, our company ranked 92d in size in the Nation. For this reason we feel that the effect of taxes on the financial operation of the Volunteer would be indicative of the effect of taxes on several hundred life-insurance companies.

Normally, after we add up all of our income and take out all disbursements, including taxes, we get what we call net gain from operation. From this net gain we increase our company surplus in order to provide necessary safeguards against future contingencies and adverse fluctuations and pay modest dividends to stockholders.

To be more specific, let us consider for a moment our 1957 operations and the effect of Federal income tax thereon. Under the current tax law, commonly referred to as the Mills law, we would incur taxes amountng to $179,600 in 1957, leaving us a net gain, which after dividends to stockholders amounting to $150,000, would enable us to increase our surplus by $96,680.

Incidentally, these dividends to stockholders represented 6 percent return on the par value of our capital stock. If the Mills law is not extended and we were to pay taxes on the basis of the 1942 law, we would have incurred taxes in the amount of $282,600 in 1957, leaving us a net loss of $6,320 for the year's operations. This situation would be even more exaggerated if the 1950 tax law were reenacted.

In this event, our taxes for 1957 would be increased to $368,167 and our surplus would have shown a considerable decrease, $91,887 to be exact.

In other words, the change in surplus after modest dividends to stockholders, using the Mills Law, the 1942 tax law, and the 1950 tax law, would be an increase of $96,680, a decrease of $6,320, and a decrease of $91,887, respectively.

It is obvious that this decrease in surplus would weaken the overall strength of the company and result in a decided increase in the cost of insurance to the general public,

Thank you very much.

The CHAIRMAN. We thank you for your statement, Mr. Woods.

Are there any questions?

Senator LONG. May I ask this question. You say you returned a 6 percent dividend this year?

Mr. WOODS. Yes, sir.

Senator LONG. And dollarwise, how much did that amount to?

Mr. WOODS. $150,000. Our capital structure, Senator, is $2,500,000.

Senator LONG. Actually, just as a matter of business judgment, if you had anticipated being taxed under the 1942 law, you would not have declared that dividend, would you?

Mr. WOODS. I doubt very seriously if we would have.

Senator LONG. You would have found it probably the safer business decision to continue at the regular policy rate without declaring a dividend?

Mr. WOODS. That is right.

Senator MARTIN. You say that 6 percent is a payment on the par value, is that it?

Mr. WOODS. Yes, sir.

Senator MARTIN. And how does the stock sell in reference to par?

Mr. WOODS. Our par value is $10, and our stock has been selling in the recent market, the last quotation in our local security market at home, Senator, was 43 bid, 47 asked.

Senator MARTIN. That is all.

Senator GORE. What has been the history of the market value of the stock in the past 10 years?

Mr. WOODS. Senator, our stock has probably, I think this would be a correct statement, probably doubled. In other words, the market value of the stock is probably double what it was 10 years ago. It might be a little more than that, but I mean it has been in that range—it is quoted at 40 odd dollars a share.

Senator GORE. Has there been a substantial decline in the past 6 months? In other words, has it followed the pattern of the stocks on the board?

Mr. WOODS. Yes, sir.

Senator GORE. How much decline?

Mr. WOODS. From 12 to 15 points.

Senator GORE. In other words, it reached——

Mr. WOODS. Sixty to probably 61, I think there was 1 transaction in the stock at 60¼ about 6 months ago. As a matter of fact, frankly, Senator, there is very little trading in our stock.

Senator GORE. Do you have copies of the financial statement of your company?

Mr. Woods. I am sorry, I do not, but I could get it here by airmail tomorrow.

Senator Gore. You don't think it would take 2 weeks to get it here?

Mr. Woods. I am sure it would not.

Senator Gore. They are printed?

Mr. Woods. Yes, sir.

Senator Gore. It would merely take a telephone call or wire to get it here?

Mr. Woods. Yes; and it would be here airmail.

Senator Gore. Since the 1942 formula permits the deduction of 77⅔ percent of net investment income, does the loss you indicate result because you need more than 77⅔ of your investment income to meet your policy obligations?

Mr. Woods. No, sir. I would not say that it does. We do have a margin on our requirements, and a comfortable one.

Senator Gore. So your projected loss is apparent but not a real one?

Mr. Woods. The projected loss—the loss that I quoted is a projected loss; that is right.

Senator Gore. Well, I think since you don't have your financial statement, I won't pursue the questions I had in mind, because you would be testifying from memory, and since you agree to submit the statement, then it will be here for the committee to examine. For one member of the committee, I am prepared to try to find ways to mitigate and ameliorate this situation which operates even as severely as the formula does with respect to your company, though your loss is apparent rather than real. But what I am faced with here, I am apparently going to be faced with voting for or against the bill that would give vast benefits to companies about which we have no information as yet as to whether they are entitled to them and as to whether it would be equitable to give the benefits to them.

For instance, the very fine gentleman from Virginia testified yesterday that his financial statement was a very strong one. When asked by me if the present law imposed a hardship on him, he said no, he wasn't asking for this tax relief because he needed it. He may have wanted it, but he didn't assert that he needed it. And the only thing advanced was that the formula operated inequitably. I wish we could wipe out all the inequities in our tax laws. There are many more inequities than here appear.

I am preparing to consider some way to mitigate the circumstance such as you present, even though the financial statement may not reveal it to be as severe as it would now appear. But I am not prepared to vote for a leap into the dark to give windfalls to people in amounts I know not, and for reasons with which I am unacquainted.

Mr. Woods. Senator, I would like to make this observation, not in complete answer to what is on your mind, but I believe this would be a statement that would be in the pattern of accuracy. There might be some variations. I opened my statement with an observation that we were 92d in size, our company. I think you would find that when you get down to companies in our size bracket, and say companies in the first several hundred, I happen to be rather familiar with their operations. Obviously we are selling life insurance in a highly com-

petitive market. And we have to furnish to our policyholders a contract that is equally as favorable, or we couldn't exist. We know that our margin, what you call net gain from operation, we don't expect them to be large. And, therefore, speaking for ourselves, and I think this would be true of the overwhelming number of companies in our size, the reason we have had a policy all these years of paying very modest dividends, very small in comparison to our earnings at all times, or try to, is because we feel that we do have to have a safe surplus to carry out these contracts, and to make our policyholders feel just as safe as if they had purchased insurance in the larger companies.

Now, I do not have a financial statement, but I can say without hesitation that if you reviewed our operations for a period of 15 or 20 years, or I reviewed them for you, with accuracy as to the figures, that our margins would not be too far away from what I quoted you today, and therefore a tax that extracted as much as we are talking about would definitely be a great hardship.

I believe it would be true of a great many companies in our size bracket.

Senator LONG. May I interrupt a second, Senator.

Senator GORE. Yes.

Senator LONG. What you are saying highlights a thought that occurred to me on this subject, Mr. Woods, and that is this. Small companies like yourself—incidentally, some of my life insurance is with a small company located in the State that I represent—have to try to present a strong capital structure in order to try to sell in competition with the large ones that have been in existence for a long period of time. And in the competition that you face, most of it is price competition to cut off from the public as much insurance as you can for the money. Now, if you are going to have a general level of taxation increased—if you are in a position to adjust yourself to it, the competition in the industry is such that everybody is at a competitive disadvantage, but what you are saying is that when you have a sudden tax increase without having time to prepare for it or anticipate it, it imposes a greater burden on you than if you had known what you were going to be up against?

Mr. WOODS. Yes, sir.

Senator GORE. Mr. Woods, I am aware, as you are, that from the standpoint of the insurance business, Tennessee, I think, has by all odds the largest amount in the southeastern part of the United States; is that right?

Mr. WOODS. That is correct.

Senator GORE. So far as I am aware, the leaders in every insurance company in Tennessee have been and are my friends. So it is with considerable pain that I take the position that I have stated to you. But let me read you the transcript, Page 136:

Senator GORE. What have you calculated your tax liability to be?
Mr. TAYLOR. On the 1942 act the liability is not the whole year's tax because part had been paid.
Senator GORE. Including the part that has been paid, what would be your tax?
Mr. TAYLOR. The tax for the year under the 1942 act was $1,694,695.
Senator GORE. What would it be under the Mills bill?
Mr. TAYLOR. $527,000 less, $1,168,000.
Senator GORE. Does the present law impose upon your company an unbearable burden of taxation?

Mr. TAYLOR. No, sir; I cannot come here begging for relief, that we have been ruined by the imposition of that tax. I am here making a plea not to extend any further than you have to a law which I believe contains unsound principles, and because I believe the equities of the situation, they say this 1942 act is added on to the Mills bill by the Treasury as sort of a safety net in case the Mills bill is found unworkable, and pending new proposals which they are preparing, I believe the equities of the situation are such that we have a right to ask for, if you choose to call it, sir, retroactive tax relief.

And he goes on and explains why.

So while you present one case, another man presents a case in which he says he is not asking for this tax relief on the basis of need. And yet there are many large companies whose financial statements we do not have, who, according to the letter here of the Prudential, would reap vast windfalls. We have no evidence whatsoever that it would be equitable for them to be forgiven that amount of tax. Now, if this bill is passed as presented, it will be labelled as the first tax reduction bill of 1958. And I think you can be sure that amendments to it would propose additional tax reduction. Now, how am I to vote against raising the personal exemption of individual taxpayers, or how am I to vote against general tax reduction if I blindly vote to give tax reduction of $124 million to insurance companies? Now, that is a problem which you, as head of an insurance company do not have, but which I as a Senator trying to serve the public interest of the whole people, have coming face to face to me.

Mr. WOODS. Senator, that is exactly why I made the remark a few minutes ago. Frankly, I wish we had a cross section of companies in size from, say, the rank of 50 down through several hundred, because I believe that our operation would not be far away from their pattern. Obviously, as we discovered yesterday—and I don't think there is a man in the life-insurance business that was here yesterday but who realized fully that there is a vast fundamental difference of opinion on our business judgment regarding any anticipation of the Mills law being reenacted again for either year during this waiting period, waiting for the Treasury Department, we are thoroughly aware of that—it so happens, and I don't think this is an incorrect statement—so as far as I know Mr. Taylor's company is the only company with whom I have come in contact that has set up as tax liability on the 1942 law.

Senator GORE. I am not asking you to put yourself into my position and making up my mind. But I do want you to know that this is not the only tax-reduction proposition that will be presented to this committee, in fact bills have already been introduced. And I would need more information than I now have before I could vote for the bill.

Mr. WOODS. Senator, I would like to be one of those to say that I would try my best to substantiate the statement that I made to you with figures.

Senator GORE. Thank you very much. I am sure you would.

The CHAIRMAN. Are there any further questions?

Thank you very much, Mr. Woods.

The next witness?

Senator SMATHERS. Mr. Chairman, our next witness I think is Mr. Lee.

Senator MALONE. Mr. Chairman, I would like to mention a matter out of order, because it is very important, and that is that we have just had a letter from the Tariff Commission refusing to take any

action on our resolution directing them to make an investigation on tungsten, on the foreign costs and domestic costs and to give us a report. Now, what they have done is simply said, it is impossible for them to do that at this time, that is the purport of what they say. And as you know, we want that report, because the House turned down, refused the appropriations sent over by the Senate to carry out the 1953 Malone-Aspinall bill as extended.

Therefore, we needed the report. Now, the Government has made contracts over the world for anywhere from $53 to $58 per unit, which is higher in some instances than the bill in the Senate called for. And everyone knows the world price, with our lower wages and lower costs, is very much lower. So I don't know what it means from a Tariff Commission whose instructions in the law are to follow such a resolution, except that the newspapers reported just recently that four members of the committee had appeared before the Ways and Means Committee and said they didn't want any responsibility of fixing tariffs, this Ways and Means Committee hearing on the extension of the 1934 Trade Agreements Extension Act. So this may be the first act of insurrection. And I suggest that the committee consider sending it back to them with a resolution that they go to work.

The CHAIRMAN. Senator, we will have to take that up at another meeting.

Senator MALONE. I know. I just wanted to mention that, because it is before the committee, and I want to draw the chairman's attention to it since no miners are at work in the United States today.

Senator SMATHERS. I would like to present to the committee Mr. Laurence F. Lee, Jr., who is one of the outstanding men of our State. He is executive vice president of a very successful insurance company which has its home office at Jacksonville, Fla.

I might say, Mr. Chairman, I regret that I have not been able to be at more of these meetings thus far, because of having to preside at the railroad hearings, but I am sure that Mr. Lee will make the kind of clear and lucid statement in his own behalf, and in behalf of the company he represents.

STATEMENT OF LAURENCE F. LEE, JR., EXECUTIVE VICE PRESIDENT, PENINSULAR LIFE INSURANCE CO., JACKSONVILLE, FLA.

Mr. LEE. I would like to thank you sincerely, Senator, and thank you for the permission to appear here today.

The CHAIRMAN. We are glad to have you.

Mr. LEE. Mr. Chairman and other distinguished members of the committee, my name is Laurence F. Lee, Jr., and I am executive vice president of the Peninsular Life Insurance Co., of Jacksonville, Fla.

The company is a stock life insurance company and is representative of any small company committed to and experiencing planned rapid growth. It is 57 years old and has $36,931,000 of assets. The capital and surplus including contingency reserves is $4½ million which is roughly 14 percent of liabilities.

This year, under the basis of the 1956 tax law, the company would pay $82,000 in Federal tax even though the company lost $81,900 on its insurance operation. You can see by this that the amount of the company's deficit is almost identical to the Federal tax if the Mills

law is effective for 1957. It stands further that under the 1942 law our deficit would be increased to approximately $120,000 and under the 1950 law, it would be increased to approximately $160,000.

Our small gains on our insurances operation in the past and our loss this year are a result of rapid growth and have been planned. However, it is extremely difficult for management to maintain an aggressive attitude in the face of threats of substantially increased taxation.

In our growth program, we had planned to absorb the Mills tax figure. Any increase in this tax burden such as would result from the imposition of the 1942 or 1950 laws would be detrimental to the security of the company and would seriously deter our growth and expansion. This would also be true for other small companies like us.

In 1955 through 1957 under the Mills bill, our Federal taxes amounted to $65,000, $71,000, and $82,000 per year, respectively. We feel very strongly that the natural growth of the company will continue to provide substantially increased revenue year after year and certainly at least a fair share of our burden for Federal taxes.

Senator KERR. If I may interrupt, Mr. Lee, you have evidently made a very careful study of this matter. Is there any other conclusion that can be reached but that the same thing that applied to your company would apply to small companies generally?

Mr. LEE. I don't know about all the other small companies, sir, but I would think this: It is extremely important for a small insurance company to grow fairly rapidly. Approximately 10 years ago, our company adopted a rather conservative attitude, and a man was brought in from one of the larger companies, and he proceeded to put in practices which had been adopted and proven good for the larger companies, and we thought it was going to work for us, and we found that it didn't. We have since had to completely turn around our operations and adopt an aggressive attitude. Now, it takes approximately $1.45 to put on a dollar's worth of new business. Therefore, any increased taxload which we must bear reduces our increase in surplus, which prevents the acceleration or rapidity of our growth. Now, whether that helps to answer your question or not, I don't know.

Senator KERR. No, except you have given me a set of facts upon which, it seems to me, you can reach only one conclusion. But you know so much more about not only your individual facts but, generally, with reference to life-insurance companies, that I would like to have your considered judgment in answer to questions. I have heard from a number of small companies in Oklahoma, and they tell me nearly the same story that you are telling here; that the 1942 act would be detrimental to them. That is the reason that I asked you if it is a fact that small companies, generally, would have somewhat the same situation as yours would have through the application of the 1942 law which, on the basis of your statement, is adverse?

Mr. LEE. Yes, sir; I think it would be extremely hurtful. As Mr. Woods pointed out, you can learn to live with a problem if you know that you are going to have time, but to adjust to it very quickly would be extremely hurtful to us, in my opinion.

Senator KERR. Thank you.

Senator SMATHERS. Would it be so hurtful to you that, if it were suddenly applied like this, it might have the result of putting you out of business?

Mr. LEE. No, sir; I don't tink so. I would hate to think that we were that dumb. We would have to seriously adjust our expansion program.

Senator KERR. It would cause a drastic change in your policies?

Mr. LEE. Yes, sir.

Senator SMATHERS. You say a change in your policies. What would it do with respect to your employment of agents and things of that nature? Would it cut down on the overhead of your operation and your advertising program and things of that nature?

Mr. LEE. It would make us consolidate our business to some extent, which would reduce our employment to some extent; yes. It would more seriously prevent us from employing more people.

Senator SMATHERS. It would more seriously prevent you from employing more people?

Mr. LEE. Yes, sir, rather than making us cut back seriously. In other words, we have a planned growth program of putting on some new men in certain areas each year, and we would have to give up that program.

The CHAIRMAN. Are there further questions?

Senator GORE. As a matter of fact, Mr. Lee, haven't you informed the committee on page 1 of your statement that the loss this year was planned?

Mr. LEE. Yes.

Senator GORE. You foresaw it?

Mr. LEE. Yes, sir.

Senator KERR. It was planned for a certain amount.

Mr. LEE. That is exactly what it was. We present to our board of directors at the beginning of the year a budget. And we are planning—I am giving trade secrets to our competitors back here—a rapid expansion in Puerto Rico. We spent considerably more in Puerto Rico than we took in. We were within about 4 or 5 percent of what we budgeted, and we also budgeted our tax liabilities on the basis that we figured they would be levied. Perhaps that was an error. But, in my experience in the business in 10 years, there has never been any occasion that there is a great desire of anyone to go back to the 1942 law. And so, using our best judment, we anticipated in the beginning of 1957, when we budgeted, we anticipated that there would be a continuation of the general principles that had been in effect for the last 6 years.

Senator GORE. In other words, your invasion of Puerto Rico territory is in the nature of a capital investment in the development of a new territory?

Mr. LEE. Yes, sir.

Senator GORE. And you had planned it?

Mr. LEE. Yes, sir.

Senator GORE. And you are not surprised at your losses in 1957?

Mr. LEE. No, sir.

Senator GORE. Then they are not attributable to the imposition of taxes under present law?

Mr. LEE. No, sir, but, if we know how much we are making in our stateside operation, and we know what the portion of the profits that we are making that we can use for a capital expenditure elsewhere, and if our taxes were increased, we wouldn't be able to use that for investment.

Senator GORE. Then your investment-income margin was not offset by mortality losses?

Mr. LEE. No, sir; I don't think so.

Senator GORE. Nor by capital losses, except in expenditure for the development of additional territory?

Mr. LEE. We had a capital loss of $845,000, which I did not mention here as part of our insurance operation.

Senator GORE. Is that taken into consideration in the summary figures which you have in your statement?

Mr. LEE. No, sir, because we were talking about the operation of the business.

Senator GORE. This is an operating budget?

Mr. LEE. It is an operating budget, and we had an operating loss of $82,000. We had an additional capital loss of $845,000.

Senator GORE. Is any part of that capital gains, or capital gains and losses?

Mr. LEE. That is it; it is our net capital loss.

Senator GORE. Do you have your financial statement with you?

Mr. LEE. Yes, sir.

Senator GORE. I will ask you some questions on it. Do you have another copy?

Mr. LEE. Yes, sir.

Senator GORE. What is your total summary of operations income on an accrual basis?

Mr. LEE. $9,875,000, roughly.

Senator GORE. What do you show as net gain to surplus account?

Mr. LEE. You mean line 33, sir?

Senator GORE. 37.

Mr. LEE. We have a deficit of $81,956.

Senator GORE. That is after your capital expenditures, and after your deductions for taxes?

Mr. LEE. Yes, sir.

Senator GORE. What do you show in line 28, "Net gain from operations before dividends to policyholders and excluding capital gains and losses"?

Mr. LEE. $81,956.00.

Senator GORE. That is given in your statement?

Mr. LEE. That is a deficit figure.

Senator GORE. Did you pay dividends to policyholders?

Mr. LEE. Yes; we did.

Senator GORE. What was your dividend?

Mr. LEE. It was based on 5 cents a share, par value of one dollar.

Senator BENNETT. Senator, I think the problem is, it isn't clear whether you mean dividend to the policyholders or dividend to the shareholders.

Senator GORE. I am trying to get the exact meaning of his insertion on line 28. It reads "Net Gain From Operations Before Dividend to Policyholders."

Mr. LEE. We are a stock company and do not pay dividends to policyholders.

Senator GORE. Your dividend was to stockholders?

Mr. LEE. Yes.

Senator GORE. That was deducted from your income before you arrived at the amount, the net amount in line 28?

Mr. LEE. No, sir, that dividend that I mentioned was paid this year. Last year we paid a dividend of 10 cents a share, which was deducted before this, yes, sir.

Senator GORE. Even though you had a loss which you had planned, you also planned to pay your dividend despite the planned loss?

Mr. LEE. Yes, sir.

Senator GORE. Thank you.

Senator KERR (now presiding). Any further questions?

Mr. Roberts, executive secretary of the National Association of Life Companies.

STATEMENT OF DeWITT H. ROBERTS, EXECUTIVE SECRETARY, NATIONAL ASSOCIATION OF LIFE COMPANIES

Senator KERR. All right, Mr. Roberts.

Mr. ROBERTS. My name is DeWitt H. Roberts. I am the executive secretary of the National Association of Life Companies, and I have a very short statement to make on their behalf. I would like to preface it by saying that this bill has been repeatedly referred to in toto as a stopgap. It is true that the formula is a temporary formula. The bill itself, however, is one that was studied for many months, reaching 3 years, by the staff of this committee, the Senate Finance Committee, and the Ways and Means Committee, and by the Treasury, and was designed to correct many obvious errors that had crept into life insurance taxation. I know it is very difficult and very frustrating for Congress, the Treasury, and for the industry to try to get a bill for an independent industry as strange as the life insurance business in which you have——

Senator KERR. Did you say "as strange"?

Mr. ROBERTS. It is a rather peculiar independent industry, Senator, in that we have competing about a thousand companies, some of them are stock companies that are both participating and nonparticipating, some of them with segregating participating assets. You even have stockholders in which the stockholders have no interest whatsoever in the surplus of the company. You have mutual companies that are operated on the town-meeting basis, others that are almost public corporations, and some, the oldest of all of them, are governed by a self-perpetuating board of trustees, which makes it a rather difficult thing.

Senator KERR. Which one is that?

Mr. ROBERTS. Many of us—most insurance men will tell you their company is the second best in the country. The best, of course, rather unanimously, by an standard, would be Presbyterian Ministers, which is the oldest in the United States, and it is operated by a self-perpetuating board of trustees.

Senator KERR. That is the Presbyterian?

Mr. ROBERTS. The Presbyterian Ministers.

Senator KERR. How do the Baptists operate, do you know?

Mr. ROBERTS. Well, Senator, we operate on a very independent basis.

Senator KERR. In Oklahoma, we Baptists are against any combine we aren't in on.

Mr. ROBERTS. The Baptists of Georgia, Senator, are still strongly against sin.

Senator KERR. As represented even by Presbyterians?

I withdraw the question.

Mr. ROBERTS. I won't endeavor to go into that phase of it.

This statement on taxation of the National Association of Life Companies is made pursuant to authorization by the association at its annual convention, in Indianapolis, on April 30, 1957, as reaffirmed by the executive committee of the association on October 14, 1957.

The National Association of Life Companies, with membership of more than 100 life insurance companies, in 23 States and the Territory of Alaska (a list of member companies is attached), urges that the present income tax act—and by that I mean the act most recently in force in the country—and its accompanying tax formula be reenacted and extended. While the association strongly approves extension for 1 year, it reaffirms its position that it would be desirable to extend the act for a 3-year period, so that the Congress, the Treasury and the industry may be able to test its fairness, equitability and productivity fully.

The 1955 act appears to us to be an excellent piece of thoughtful legislation. It closes a number of loopholes for tax avoidance of an unfair type that existed in previous acts. Especially, it provides an effective definition of a life insurance company, that has prevented the use of a nominal life insurance corporation as an investment operation.

The 1955 act provides a workable and fair tax formula. It does not exempt from taxation any type of contract or business within the industry. For the first time it fully and properly distinguishes the peculiar problems of new life insurance companies, as well as those of small companies; the 1942 act took cognizance of the problem of small companies, though inadequately, but made no provision for newly organized life insurance companies during the initial period when, even with the most skillful operation, they were certain to be operating at a loss.

Most notably, the 1955 act is flexible as a revenue measure. Recognizing the inherent difficulties of a formula system for any industry, but also recognizing the practical and almost insurmountable difficulties of writing a tax bill for the life insurance industry that is not based upon a formula, this measure is not open to the objections of its predecessors. It can never "go off the board"; it can be adjusted to sharply changed economic conditions by a simple amendment to the deduction formula. At all times it is keyed to the general corporate tax structure.

This has not been true of any previous measure. By that I mean any recent previous measure. The 1921 act was keyed in a fashion to the general corporate level. Revenues obtained were always variable, to an extent unusual and unexpected in an industry so generally stable as life insurance. The 1942 act finally reached a point where it produced no revenue. The 1950 act could do likewise and is also open to the serious criticism that it burdens heavily smaller and growing companies and produces irrational results, including relatively heavy

taxation upon companies that failed to earn the interest required to maintain their reserve structure and were thereby forced to dip into their surplus.

The National Association of Life Companies does not contend, as many people do, that investment income is the entire income of a life insurance company; we only assert that investment income is a suitable measure of the income of all life insurance companies except those that are just entering the business; there are other possible yardsticks by which the true earnings of the industry may be determined with fair accuracy and reasonable equity.

Nor does the National Association of Life Companies insist that the total-income approach cannot be written into statute; it only points out that many attempts over many years have been made to write such a theory into legislation and that those efforts have failed, as the most eminent Treasury expert of the twenties asserted they always would.

Nor does the National Association of Life Companies assert that a total-income approach would destroy the industry; it would not do so, but it would require serious readjustments, and would handicap regulatory agencies over a period of at least 5 or 6 years. It would also cost the industry many millions of dollars to install completely new and far more expensive accounting procedures.

The National Association of Life Companies believes that the investment income formula approach, as presently embodied in the 1955 act, is fair and reasonable. The bill recognizes the special problems of a new company during its organizational period and fixes the dividing line in profits at a limit that represents the transition from a small and struggling operation to a still small but stable and profitable enterprise; the Senate's amendment to H. R. 7201 in 1955, providing a higher deduction on the first million dollars of investment income, has met with general industry approval. We think that is the fair way to reach help to the small companies.

We believe that the present measure deserves a fair test. It is producing approximately 18 percent more revenue than the immediately preceding 1951 stopgap. Under conditions which prevailed in 1950, it would have produced 383 percent of the yield of the 1942 act and 157 percent of the yield of the 1950 formula. Comparisons show that the present formula has a stability that the previous measures lacked.

There would also be losses of revenue incidental to the striking of those sections of the present law that close avoidance loopholes and that, through a definition of "life company," prevent other types of operations from masquerading under that name.

The present measure has been more productive to the Treasury than any previously adopted; it appears to distribute the tax burden of the industry more fairly among the more than 1,000 companies engaged in the business; it possesses the qualities of simplicity, equitability and satisfactory yield that are the components of good tax legislation. This association believes that it should be given a reasonable period of test before it is rejected in favor of some previously unsatisfactory measure or superseded by some wholly untried novelty.

We think it is pretty good, because we think it gets the most valid news with few exceptions.

Senator FREAR. (now presiding). Any questions?

Thank you very much, Mr. Roberts.

(The list of Member Companies of the National Association of Life Companies referred to above is as follows):

MEMBERS OF THE NATIONAL ASSOCIATION OF LIFE COMPANIES

(As of January 1, 1958)

Acme Life, Springfield, Ill.
American Buyers, Phoenix, Ariz.
American Foundation Life, Little Rock, Ark.
American Standard Life, Fort Worth, Tex.
Beacon Life, Oklahoma City, Okla.
Cardinal Life, Louisville, Ky.
Citizens Standard Life, Corpus Christi, Tex.
Continental Service Life & Health, Baton Rouge, La.
Empire Life, Little Rock, Ark.
Farm & Ranch Life, Houston, Tex.
Fidelity Standard Life, Baton Rouge, La.
First United Life, Gary, Ind.
Georgia Life & Health, Atlanta, Ga.
Great Commonwealth Life, Dallas, Tex.
Guaranty Income Life, Baton Rouge, La.
Harrison National Life, Indianapolis, Ind.
Illinois Security Life, Sterling, Ill.
International Life, Austin, Tex.
Acme National Life, Shreveport, La.
American Capitol, Houston, Tex.
American Life Savings, Miami, Fla.
American Trust Life, Wichita Falls, Tex.
Capitol National Life, Houston, Tex.
Charter Oak Life, Phoenix, Ariz.
Coastal States Life, Atlanta, Ga.
Cotton States Life, Tuscaloosa, Ala.
Estate Life, Amarillo, Tex.
Federal Old Line, Federal Way, Wash.
First National Life, Atlanta, Ga.
Freedom Life, Greenville, S. C.
Girardian Insurance Co., Dallas, Tex.
Great Southwest Life, Phoenix, Ariz.
Guaranty Savings Life, Montgomery, Ala.
Hermitage Health & Life, Nashville, Tenn.
Independent Life, Little Rock, Ark.
Interstate Life, Dallas, Tex.
Alaska Western Life, Anchorage, Alaska
American Home Life, Spencer, Iowa
American Security Life, Fort Wayne, Ind.
Bankers Service Life, Oklahoma City, Okla.
Capitol Co-operative, Denver, Colo.
Citizens National Life, Indianapolis, Ind.
Commercial Travelers Life & Health, Dallas, Tex.
Early American Life, Atlanta, Ga.
Family Protection Life, Centralia, Ill.
Fidelity Reserve Life, Little Rock, Ark.
First Pyramid Life, Little Rock, Ark.
General Life of Arkansas, Little Rock, Ark.
Golden Rule Life, Lawrenceville, Ill.
Great Western Life, Oklahoma City, Okla.
Gulf Union Life, Baton Rouge, La.
Home Trust Life, Montgomery, Ala.
Intercoast Mutual Life, Sacramento, Calif.
John Marshall Life, Birmingham, Ala.
Lee National Life, Shreveport, La.
Life of Kentucky, Louisville, Ky.
Mid American Life, Houston, Tex.
National Bankers Life, Dallas, Tex.
National Old Line, Little Rock, Ark.
National Union Life, Birmingham, Ala.

Perpetual Life, Denver, Colo.
Pioneer Life & Casualty, Gadsden, Ala.
Professional & Business Men's, Denver, Colo.
The Service Life, Fort Worth, Tex.
Southeastern Life, Hattiesburg, Miss.
Southwest American Life, Houston, Tex.
State Life of South Carolina, Columbia, S. C.
Tidelands Life, Bunkie, La.
Union Bankers Life, Dallas, Tex.
United Federal Life, Houston, Tex.
Universal Life & Accident, Bloomington, Ind.
Washington Standard Life, Little Rock, Ark.
Western Mutual Life, Moline, Ill.
Liberty Life & Casualty, Goodland, Kan.
Life of Alaska, Anchorage, Alaska
Mid Continent, Shreveport, La.
National College & University, Atlanta, Ga.
National Security Life, Indianapolis, Ind.
Oil Industries Life, Houston, Tex.
Pinnacle Old Line, Little Rock, Ark.
Preferred Life Assurance Society, Montgomery, Ala.
Security National Life, St. Louis, Mo.
Skyland Life, Charlotte, N. C.
Southern Colonial Life, Columbia, S. C.
Southwest Union Life, Dallas, Tex.
Tennessee Life & Service, Knoxville, Tenn.
Trans-American Life, Fort Worth, Tex.
Union National Life, Atlanta, Ga.
United Insurance Co., Chicago, Ill.
Wabash Life, Indianapolis, Ind.
Western Bankers Life, Dallas, Tex.
Western Security Life, Oklahoma City, Okla.
Life of Alabama, Gadsden, Ala.
Life of South Carolina, Columbia, S. C.
National American Life, Baton Rouge, La.
National Life & Casualty, Phoenix, Ariz.
National Security Life Accident, Dallas, Tex.
Pan Coastal Life, Mobile, Ala.
Pioneer American, Fort Worth, Tex.
Preferred Life, Dallas, Tex.
Security Savings Life, Montgomery, Ala.
South Atlantic Life, Tampa, Fla.
Southern Equitable Life, Little Rock, Ark.
Standard Union Life, Montgomery, Ala.
Tennessee Valley Life, Jackson, Tenn.
Treasure State Life, Butte, Mont.
United Bankers Life, Dallas, Tex.
United Security Life, Birmingham, Ala.
Washington Life of America, Lafayette, La.
Western Fidelity Life, Fort Worth, Tex.
Western & Southern Life, Cincinnati, Ohio

Senator FREAR. The next witness is Mr. E. J. Schmuck, vice president and general counsel of Acacia.

STATEMENT OF EDWARD J. SCHMUCK, VICE PRESIDENT AND GENERAL COUNSEL, ACACIA MUTUAL LIFE INSURANCE CO.

Mr. SCHMUCK. My name is Edward J. Schmuck. I am vice president and general counsel of the Acacia Mutual Life Insurance Co., which is a mutual company, as its name indicates, organized by act of Congress and domiciled in the District of Columbia.

I have associated with me here, in view of the direction that some of the questions has taken, the second vice president and an associate actuary of our company, Mr. William Simpson.

I would hope that if the questions get into the details of the annual statement that I might be privileged to consult with Mr. Simpson or have him make the answers.

Senator FREAR. Sure.

Mr. SCHMUCK. Acacia Mutual Life Insurance Co. urges that your committee report favorably upon H. R. 10021, and urges further that no other action be taken at this time amending the provisions of subchapter L, Internal Revenue Code of 1954, governing the taxation of life-insurance companies. We express our appreciation at this point for the active interest of your committee in bringing about the promised completion by April 7 of the long-pending Treasury Department studies looking toward development of a sound, practical, and equitable permanent formula for taxing the life-insurance companies.

We believe that H. R. 10021 should be enacted.

H. R. 10021, approved by the Treasury Department and unanimously adopted by the House of Representatives, merely extends to cover taxable year 1957 the stopgap formula under which life-insurance companies were taxed in 1955 and 1956.

The most succinct and perhaps best stated reason for enactment of H. R. 10021 is set out in a single sentence of the report of the Committee on Ways and Means to accompany the bill (Rep. No. 1296) reading as follows:

> Your committee believes that it would be unreasonable to return to a fundamentally unsound tax formula simply because under the changed conditions of 1957 it would produce a larger amount of revenue (p. 2).

That statement was made with respect to the 1942 formula. The 1950 formula is equally "fundamentally unsound," for it is basically the 1942 formula with specific factors changed to lower the so-called Secretary's ratio.

The cited report then goes on to state:

> Accordingly, since the Treasury Department has not as yet fully developed its proposal to provide a permanent method of taxing life-insurance companies, and in view of the fact that the Secretary of the Treasury has informed your committee that specific proposals will be advanced in the near future, your committee is unanimous in urging the passage of H. R. 10021 (p. 2).

Hon. Wilbur D. Mills, chairman of the Committee on Ways and Means has given capable, conscientious and careful study in recent years to the complex subject of taxation of life-insurance companies. Expanding upon the conclusions of the Committee on Ways and Means, Mr. Mills presented H. R. 10021 for the favorable consideration of the House for these reasons:

1. The 1955 formula contains several basic improvements in technique which would be lost if the formula reverted to the 1942 provisions.
2. The 1955 formula provides significant benefit for small life-insurance companies.
3. The 1955 formula provides a more realistic method of taxing the accident and health business of the life-insurance companies.
4. The life-insurance industry had reason to assume in its financial decisions during 1957 that the 1955–56 tax rate would be continued.
5. The practical effect of permitting the 1942 formula to again become effective would be very much like a retroactive increase in taxes.
6. The 1942 formula is fundamentally unsound.

7. It seems unreasonable and unfair for Congress to reinstate the 1942 formula because it will now produce more revenue, after Congress became dissatisfied and abandoned it earlier because it produced too little revenue (Congressional Record, January 30, 1958, pp. 1176–1177).

The 1955 formula, proposed to be extended to cover tax year 1957 by H. R. 10021, in our opinion has both basic and specific defects. Nevertheless, we support its extension for the reasons advanced by Mr. Mills and for additional reasons. Among the most important additional reasons is that reversion to the 1942 formula would materially alter the distribution of the industry's tax burden among the individual life-insurance companies. Diminution of the tax burden applicable, under the 1955 law, to accident and health business would be accompanied by increase in the tax burden referable directly to the life-insurance business of the companies. The small companies would lose the ameliorating provisions of the 1955 formula and would have to absorb a disproportionate part of the increased tax. Above all, there would result a marked increase in the taxes payable by all companies without regard to the ability of the individual company to pay, the redistribution of the tax burden among the companies, or the essential unsoundness heretofore determined by both the Senate and the House of Representatives to be inherent in the 1942 formula.

In the case of our own company, our Federal income tax for 1949 amounted to about $160,000. For the year 1957, our tax under the 1955 formula is estimated to be $975,000, slightly more than 6 times the 1949 law. On no basis of comparison, business in force, assets, additions to surplus or any other basis, has the growth of our company approached in proportion the rate of increase of our taxes. Were the 1942 or the 1950 formula in effect for 1957, our tax would be respectively more than 9 times and 12 times the amount of tax paid in 1949. The increased resultant tax payable by our company under either the 1942 or 1950 formula would exceed the amount reserved for surplus from the 1957 operations.

If I may, I would like to interpolate the figures substantiating that last sentence. In 1957, as a part of our total operation, we introduced a new group of policies which required allocation to policy reserves of about $1 million more than our older policy series would have required. $2,848,000 were allocated, and that decision had to be made early in 1957, to policyholder dividends, or refunds. $115,000 was allocated to strengthen reserves on annuity and installment settlements with beneficiaries. Taking all operational income and disbursements into account, we had, at the end of the year $1,301,201 left from all operations. Of this, based on the stopgap formula, $981,000 was allocated to Federal income taxes, leaving about $320,000, which the company allocated to surplus. If our taxes must be computed on the 1952 formula, the amount will be about $1,547,000. Under the 1950 formula, it would exceed $1,900,000. The added tax liability under either of these formulas would exceed the total amount reserved for surplus from our entire operation in 1957, and would actually require reduction of surplus accumulated in prior years to the extent of about $150,000 under the 1942 formula, and about $610,000 under the 1950 formula.

To permit such a result without the opportunity for full discussion, full hearings, and full consideration of the matter in both the Senate and the House would be unfair both in principle and taking into

practical account management decisions which cannot now be reversed. Time alone precludes such necessary action and deliberate consideration in both houses if a bill is to be enacted into law by March 15.

The judgments expressed by both the Treasury and the Committee on Ways and Means that the 1955 formula should be extended by H. R. 10021 to cover the taxable year 1957 is firmly founded in the facts and in good faith and conscience. We ask that your committee, weighing all of the considerations involved, also act favorably on the bill.

We would like to go further in our statement with a brief discussion of the need for a proper permanent formula for taxing life-insurance companies. In the first portion of this at the bottom of page 4, if I may briefly make a statement, and then have the full text absorbed in the record, we point out the management necessity as well as the congressional disturbance which is involved in this recurrent requirement that Congress consider stopgap legislation for life-insurance companies. We point out further that as a practical matter, in the orderly operation of a life-insurance company, a number of decisions already have had to be made effective for the year 1958, which have required a judgment as to the Federal tax situation which will obtain for this year. It is important that this continuous uncertainty be relieved by permanent legislation. The permanent legislation, however, should eliminate averaging.

(The portions of the text summarized by the witness read:)

The recurring necessity for Congress to consider special stopgap legislation for the taxation of life-insurance companies is an obvious disturbance to the legislative branch of our Government. The uncertainties consequent upon the lack of a permanent tax bill are equally disturbing in the efforts of company management to project and thereby take into account the long-range implications of the operational decisions which must be made by management. Due recognition may be given to the long-range impact of a defined tax method which will result in increased tax liability by reason of normal growth of a company. It is also reasonable to take into account in the making of management decisions the possible impact of tax increases uniformly applied with respect to all taxpayers. But, so long as the Federal taxation of life-insurance companies remains a substantial uncertainty both because the Government itself holds each successive formula to be temporary and because the formulas are based on so-called industry averages, individual companies face the threat of indeterminate and possibly excessive taxation. To the life-insurance business, with its long-range contracts extending often over several generations, this uncertainty is substantial and serious.

As a practical matter, in the orderly operation of a life-insurance company, a number of decisions already have had to be made effective for the year 1958 which have required a judgment as to the Federal tax situation which will obtain for this year. It is important that this continuous uncertainty be relieved by permanent legislation.

To a large extent, the imposition of excessive taxes upon individual companies within the life insurance industry is a consequence of the so-called averaging method underlying all of the formulas under which the companies have been taxed since 1942.

Senator BENNETT. Might I interrupt?

Was that also applicable to the 1942? When you say since 1942, you mean including the 1942 formula?

Mr. SCHMUCK. Yes.

Senator BENNETT. Thank you.

Mr. SCHMUCK. It seems obvious that any averaging system must have a greater impact upon some companies than upon others. In the case of the life-insurance industry, there is widespread variation in the results in different areas of the operations of the individual companies. Yet it is by a method of aggregating these results that there have been derived the averages underlying the tax formulas in effect since 1942. Furthermore, even the so-called averaging is a misnomer because of arbitrary adjustments contained in the several formulas. Of these, the "elimination of the negatives" in the 1950 formula causes the most adverse effect for individual companies.

Acacia consistently has maintained that a permanent tax formula for life-insurance companies should be adopted and that it should be founded upon the principle that each company will calculate its taxable income on the basis of its individual operating experience. Both the Congress and the Treasury Department have given recognition to the need of the life-insurance companies for permanent legislation and the Treasury Department has recorded before your committee its conviction that the averaging methods basic to the life-insurance tax formulas since 1942 are fundamentally unsound. In the hearings before your committee on July 25, 1955, on H. R. 7201 the then witness for the Treasury Department stated that Department's basic position in the following responses to questions of an eminent member of your committee (hearing before Committee on Finance on H. R. 7201, p. 26):

Senator KERR. In your judgment, is there any basis for this 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.

Other statements in the record of the same hearing and even as far back as the hearings before your committee on House Joint Resolution 371 in March 1950 reflect the Treasury Department's basic position that the averaging concept underlying the life insurance company tax formulas since 1942 is unsound. (See statement of C. M. Lewis, Office of the Tax Legislative Counsel, Treasury Department, Hearings of Senate Finance Committee on H. J. Res. 371, p. 89.) With this we are in complete accord.

The record of both your committee and the Committee on Ways and Means of the House of Representatives contains numerous references to the Treasury's purpose to make available to Congress the products of its long study of the subject of life-insurance company taxation and its recommendations for a permanent formula for such taxation. Both committees of Congress have stated their desire to receive and consider the Treasury's recommendations and report. The last published commitment—that is up until yesterday morning—of the Treasury Department in this respect is contained in a

letter of the Secretary of the Treasury, dated January 10, 1958, and reportedly addressed to the chairman of the Senate Finance and House Ways and Means Committee. The pertinent paragraphs, apparently adverted to in the previously cited report of the Ways and Means Committee on H. R. 10021, read:

> The Treasury Department believes that it is most desirable that a permanent method of taxation of life-insurance companies be worked out, and we hope to propose in the very near future an approach which we believe will be reasonable and equitable for the foreseeable future.
>
> I am sure that the House Ways and Means and the Senate Finance Committees will want to consider any such proposals in the light of testimony that will be submitted and other considerations which the members of your committee may want to suggest or evaluate.

Permanent legislation, if it is to be sound, practicable and equitable should proceed from the report to the Congress and the individual life-insurance companies of both the Treasury's recommendations and the information uniquely available to the Treasury and undoubtedly carefully compiled in the course of its studies. Each life-insurance company should have the opportunity to review the Treasury's recommendations and such data, relate them to the individual company and the industrywide operational results, and present fully to the Congress its views with respect to them. Finally, upon the deliberate consideration by the Congress of the results and recommendations flowing from all such studies, permanent legislation should be enacted. To this course our company unqualifiedly subscribes. We sincerely appreciate the exercise of your committee's influence in securing the Treasury's commitment that its study and recommendations will be released as promptly as possible.

On the other hand, precipitate action on permanent legislation—or even on temporary legislation—can have consequences which, though perhaps unintended, will be markedly unfair and might seriously prejudice the competitive and even the financial situation of individual companies. Such results, we firmly believe, would be as undesirable to your committee as to the life-insurance companies.

The 1942 formula was abandoned by Congress in 1950. It was unsound then. It still is. The short-lived 1950 formula was abandoned by Congress in 1951, with the agreement of the Treasury and the unanimous concurrence of the life-insurance companies. It was unsound then. It still is. The 1950 formula, if revived, would be extremely and disproportionately burdensome to some companies. The elements of that formula are designed to accomplish the conflicting purposes of taxing all free interest of companies having free interest, but, by a so-called averaging method, diverting substantial tax liability from those with much free interest to those with little or no free interest. The 1950 formula is deficient in its method of measuring the taxable income of individual life-insurance companies. It is even more deficient in its method of distributing the tax burden among the companies.

It is these inseparable problems upon which the Treasury's study should cast some light. Because of them we urge that permanent legislation follow the most careful and thorough consideration by the Congress of all factors involved.

Acacia is a mutual life-insurance company. It is owned by its policyholders. Any taxes imposed upon Acacia are a charge against

its policyholders. Taxes must be paid as part of annual operating costs, or by reduction or elimination of dividend refunds made to policyholders, or by depleting the surplus held for the benefit of its policyholders and owned by them.

Acacia has been and is willing to pay its fair share of taxes. It wants no other company to pay more because of Acacia's operation. Acacia wants to pay no more because of some other company's operation.

We believe that Congress, in tax legislation affecting life-insurance companies, shares with the institution of life insurance the responsibility for preserving with strength the financial integrity of the life-insurance policies of our millions of American policyholders. For the reasons we have set out, we submit that this responsibility will best be exercised at this time by:

1. Enactment of H. R. 10021 in its present form.
2. The earliest possible presentation to the Congress and release to the companies of the Treasury's proposals for permanent legislation.
3. Enactment by Congress of permanent legislation for the taxation of life insurance companies upon full hearings and careful consideration of the Treasury's and all other pertinent recommendations.

The CHAIRMAN (again presiding). Are there any questions?

Thank you, very much for your presentation.

I think Mr. Thoré has a statement to make to the committee.

STATEMENT OF EUGENE M. THORÉ, VICE PRESIDENT AND GENERAL COUNSEL, LIFE INSURANCE ASSOCIATION OF AMERICA

Mr. THORÉ. Mr. Chairman and members of the committee, my name is Eugene M. Thoré, vice president and general counsel of the Life Insurance Association of America.

The question of retroactivity has come up before this hearing both yesterday and today. And it seemed to us that the record on that point is not complete. So last evening I put together some rough notes on the question. They are not very long, and with your indulgence, I would like to present them to you in the hope that they will be helpful.

Now, the question of retroactivity must be considered in connection with this bill that is pending before you. We agree of course that the enactment of any tax law after the taxable year, the taxable event, should be very carefully studied from the standpoint of retroactivity. We feel that the basic question to be considered is whether action after the end of the tax year is repugnant to sound public policy. And in deciding this question, according to the precedents I have studied, it has been the practice of this committee to examine the facts in each situation, and square them with the established legislative precedent. It has not been the practice to decide this question entirely upon the question of whether the legislation is being considered after the end of the tax year.

Now, first as to the facts in connection with H. R. 10021. And these, I don't believe, are in the record, Mr. Chairman. Early in the summer of 1957, when it seemed to us that the Treasury would not produce a new plan in time to permit Congress to have hearings thereon and pass legislation at the end of the session, we approached

the Honorable Wilbur Mills, then chairman of a subcommittee of the House Ways and Means Committee, having jurisdiction over this question. We asked that he introduce a bill extending the Mills formula to apply to tax year 1957. Mr. Mills was willing to introduce such a bill provided the Treasury would take a favorable position at that time on such an extension.

And may I point out that at that time it was still expected that the Treasury would offer a proposal for permanent legislation in the fall. And consequently Mr. Mills felt that an expression of the Treasury's attitude toward an extension was essential to the consideration of an extension bill.

So in July of last year, 1 week after Secretary Anderson took office, we asked the Secretary to consider the matter and communicate his position to the chairman of the Ways and Means Committee. And at a conference with Secretary Anderson shortly after that first conference in July, he stated that he was too new in his position to pass on the merits of an extension, and that other duties were so heavy he would not be able to give the matter consideration at the current session of the Congress.

He pointed out that the Treasury still had hope of bringing forth a new proposal for the taxation of life-insurance companies before the next session of the Congress.

And further, he stated that he was informed that if an extension became necessary, the same result could be obtained by the passage of a law at the next session prior to March 15, 1958, and that such a practice has been followed at least twice before in the area of life-insurance company income tax legislation.

He assured us that he would give the matter consideration and make his position known prior to the next session of the Congress.

Following these conferences with the Secretary of the Treasury, we again consulted Congressman Mills, and he in turn conferred with the then chairman of the Ways and Means Committee.

Following these conferences, we were informed that under all the circumstances the chairman of the Ways and Means Committee was opposed to bringing an extension bill before his committee during the current session of the Congress, but would consider such legislation at the beginning of the next session, when it was expected that Secretary Anderson would submit his recommendations.

Under date of November 20, 1957, we addressed a letter to the Secretary of the Treasury—and I speak of the company associations—again urging that the Treasury make known its position with respect to an extension of the Mills formula at the earliest possible date. On January 10, 1958, the Secretary addressed correspondence to the chairman of the Ways and Means Committee and the chairman of the Senate Finance Committee agreeing to an extension of the Mills formula.

Senator ANDERSON. Would you read that sentence again, please?

Mr. THORÉ. Yes. On January 10, 1958, the Secretary addressed correspondence to the Chairman of the Ways and Means Committee and the Chairman of the Senate Finance Committee agreeing to an extension of the Mills formula.

Immediately upon receipt of this letter, Congressman Mills introduced H. R. 10021 in the House. The bill was reported favorably on January 23, and passed the House on January 30.

It was considered by this committee in executive session on February 1.

The CHAIRMAN. Did they vote on it in the House? Was there a recorded vote?

Mr. THORÉ. It was not a recorded vote, but there were no dissents to the voice vote.

The CHAIRMAN. What was the vote in the Ways and Means Committee?

Mr. THORÉ. Unanimous.

Now, these are the facts which bring us up to these hearings. The point we would like to stress in particular is that every effort was made by the industry to bring about the introduction and passage of an extension bill during the 1957 session. There were two principal complications. First, there was still some hope that the Treasury would bring out its proposal for permanent legislation in time to give it consideration prior to March 15, 1958, return date. Second, Secretary Humphrey was leaving office, and Secretary Anderson was just taking office, and the latter was completely unfamiliar with the subject, and felt that he should have additional time to study it before making a recommendation.

Now, as to precedents.

Senator ANDERSON. Would you go back and read again the section where you referred to what the Secretary said in his letter?

Mr. THORÉ. I used the word "agreeing".

Senator ANDERSON. Is that in his letter?

Mr. THORÉ. It is in his testimony before the House, and his statement on the House floor interpreted his letter; it is a rather long letter.

Senator ANDERSON. I asked about the testimony the other day. Have we got the testimony back here?

Mr. THORÉ. The testimony says he agrees.

May I proceed?

Senator ANDERSON. He says "We have already advised the committee that the Treasury is agreeable". Therefore, I assume that he refers to the previous advice. And that advice says that the Treasury will go along with the extension of——

Mr. THORÉ. I will be glad to substitute the "go along with" in this statement or the "agreeable with", either one.

Now, I would like to turn to precedents, if you think that would be appropriate.

The CHAIRMAN. Proceed, sir.

Mr. THORÉ. The factual situation I have described is practically on all fours with the facts surrounding the enactment of the 1950 law applicable to the taxation of life insurance companies.

Senator ANDERSON. When was the 1950 law introduced into the Congress?

Mr. THORÉ. I am coming to that. I will give you the exact date.

On October 10, 1949, the then Secretary of the Treasury recommended that stopgap legislation be enacted covering tax years 1948 and 1949. It is important to note that this was in 1949. His recommendation was in the form of an amendment to the 1942 law, which at that time was producing no revenue. On the same date—and I think this is the date you want Senator Anderson, October 10, 1949—

the chairman of the Ways and Means Committee introduced House Joint Resolution 371, carrying out the Treasury's recommendation.

Senator ANDERSON. Did that affect the tax for 1948, except in normal fashion, let the life insurance companies make some small nominal contribution to the Treasury?

Mr. THORÉ. In 1948, the 1942 law, which was then in effect, produced no tax, and this bill——

Senator ANDERSON. Did the bill you mention produce some tax for 1948?

Mr. THORÉ. It actually didn't in the end. I will come to that.

Senator ANDERSON. It actually did or didn't?

Mr. THORÉ. It did not in the end.

Senator ANDERSON. So that it did not retroactively go back and change 1948?

Mr. THORÉ. That is correct.

Senator ANDERSON. And it did apply to 1949 only, and the proposal came in in the introduction of the bill during the calendar year?

Mr. THORÉ. That is correct.

Senator ANDERSON. When you get through, will you give us a precedent for the introduction of a bill after the ending of the calendar year?

Mr. THORÉ. I will try to make that point later.

Senator ANDERSON. Make the precedent.

Mr. THORÉ. It is in the precedent—it is a little complicated, I regret, but it is there.

Now, the Ways and Means Committee took no action on this resolution during 1949. On January 20, 1950, they reported the resolution applying to tax years 1947, 1948, and 1949.

From the standpoint——

Senator ANDERSON. Applied to it in what way? Did it increase the taxes?

Mr. THORÉ. It applied the formula in this bill to each of the years. And I will be glad to tell you what the formula would have produced.

Senator ANDERSON. Did it increase the taxes?

Mr. THORÉ. Yes, sir.

Senator ANDERSON. And your point is that it is perfectly within the precedent to increase the taxes?

Mr. THORÉ. Yes, sir.

Senator BENNETT. Or decrease them?

Senator ANDERSON. This didn't decrease them. It increased them.

Mr. THORÉ. There are precedents for decrease too.

Senator GORE. Then you are not undertaking to deny that the Mills bill is a retroactive tax-reduction measure?

Mr. THORÉ. My view is this, that the 1942 law is now in effect. It applied to the taxable event 1957. It is still in effect. The 1957 tax is due on March 15. There is no liability prior to that date.

Senator ANDERSON. Due and payable?

Mr. THORÉ. The tax is not now due and payable. There is no liability, as I see it, until March 15.

Senator ANDERSON. That is interesting. No liability.

Mr. THORÉ. I don't think the Government could sue for it before March 15.

Senator GORE. Well, the answer, then, is yes, the Mills bill does provide for retroactive tax reduction?

Mr. THORÉ. It is retroactive in this sense, that it is being considered after the taxable event, and before the due date of the liability.

Senator CLARK. That is a qualified "yes." All right.

Mr. THORÉ. It is very difficult to express such a situation.

Now, there were hearings on this House bill we are discussing before this committee on March 16 and March 20, 1950. Now we are in the year after the last taxable year that was covered in this bill that passed the House in January of 1950. It covered tax years 1947, 1948, and 1949. And we are now in 1950. And that is when this committee——

Senator BENNETT. And we are past the March 15 date?

Mr. THORÉ. We are also past the March 15 date.

A large part of the testimony at the hearing before this committee was devoted to this question of retroactivity. And I hope you have the opportunity—probably you already have—to read the record of the full hearing, because it is very interesting.

The life insurance organizations did not object to the retroactivity features of the resolution. They didn't object to going back 3 years. But there was strong objection by individual companies. The opposition of these witnesses was directed mainly to the application of the resolution to tax years 1947 and 1948. There was no objection to the application to 1949.

Senator ANDERSON. Actually if it were applied to 1947 and 1948, it would have produced something like $1,600,000, a small amount.

Mr. THORÉ. It would have produced substantial revenue; I don't have those figures here, but it would have produced substantial revenue. I will tell you what it would have produced in 1949. It was $42 million in 1949. And I think these other 2 years would have been——

The CHAIRMAN. You speak of resolution. Do you mean a law?

Mr. THORÉ. It was a House joint resolution. We will call it a bill.

Senator KERR. What you are referring to was legislation?

Mr. THORÉ. Yes, sir.

Senator KERR. And it was passed?

Mr. THORÉ. Yes.

Senator KERR. And it did become effective?

Mr. THORÉ. But not in the form it passed the House.

Senator KERR. As amended?

Mr. THORÉ. It eventually passed.

Senator KERR. I wasn't here, but I take it that the gist of your position is that action by the Congress in 1950 increasing the taxes that companies paid for 1947, 1948, and 1949, would at least be precedent for legislation that was retroactive to increase taxes; is that right?

Mr. THORÉ. That is right.

Senator KERR. And you are suggesting that it might even be the basis for the degree or retroactivity that would be involved in the passage by the Senate of the Mills bill?

Mr. THORÉ. That is correct, with this one addition, that in this situation in 1950, there was both an increase problem and later a decrease problem; both of them are involved. It is quite complicated. I hope I can explain it.

Senator KERR. Mr. Thoré, you are a brave man to sit there and remind Congress of indiscretions it may have made. I take it that you have done so, at least so far as you are concerned, in what you hope is

an objective matter, and speaking as a historian and not as a lecturer; is that right?

Mr. THORÉ. I am here simply to report facts. I am not here to——

Senator KERR. I say, as an objective statement, and as a historian.

Mr. THORÉ. That is correct.

Senator KERR. That gives me some comfort.

Mr. THORÉ. I will do my best.

Senator GORE. Would it not be possible for the Congress to provide an equal amount of dollar tax relief after April 15 as before April 15?

Senator BENNETT. March 15?

Senator GORE. March 15. Thank you.

Mr. THORÉ. I think that under the law, there is no limitation, if the action comes fairly close to the taxable event.

Now, it would be up to you gentlemen to decide whether under all the circumstances of the particular case you were getting too far away from the taxable event. And therefore you were doing something that was repugnant to public policy. I think that is the nub of the question.

Senator GORE. You know I think it is a little repugnant to public policy to pass a bill which has not had adequate consideration. It seems to me that we could wait until we have the recommendation of the Treasury on April 7, which has now been promised. We could then proceed with some more knowledge than the committee now has.

Mr. THORÉ. A delay does introduce a problem. Under the law we have to make returns and pay the tax on the 15th.

Senator GORE. But the question I am asking is this. Could Congress act after March 15 as well as before March 15, and provide an equal dollar amount of revenue, even though it amounted to a rebate.

Mr. THORÉ. Legally, I think that is right.

Senator GORE. To the treasurers of the companies, it would be the same whether it is tax reduction retroactively or a rebate after the tax had been paid.

Senator KERR. It is not exactly the same, you can visualize some difference in there, in that they either would not have had continuing use and therefore the earning power of the money, where if they had to pay it back—if they had to pay it and then hoped to get it back, there would be some difference there.

Senator GORE. I would recognize some interest component.

Thank you.

Mr. THORÉ. Here is what the Senate Finance Committee did in 1950 on House Joint Resolution 371. It reported the resolution, or we will call it a bill, favorably by unanimous vote on April 10, 1950. They were persuaded that they should not make it applicable to tax years 1947 and 1948. They amended the bill making it applicable to tax years 1949 and 1950.

The action was taken in 1950. Now you will note that they also added tax years 1950 by amendment. And in this form the bill passed the Senate on April 13, 1950.

Now in discussing——

Senator ANDERSON. What happened in conference? You have got us all interested.

Mr. THORÉ. It went to conference, and there was agreement.

Senator ANDERSON. On that basis?

Mr. THORÉ. Yes.

Senator ANDERSON. So they did not go back and pick up 1947 and 1948.

Mr. THORÉ. That is correct, they picked up 1949.

Senator ANDERSON. So it applied to 1949, which was the year in which the bill had recently been introduced.

Mr. THORÉ. That is correct.

Senator ANDERSON. And it also applied to 1950?

Mr. THORÉ. That is correct.

Now, I would like to read just a very short quote which will give you the gist——

Senator ANDERSON. And the date of April 13 is somewhat significant. It gives a point to what Senator Gore has been saying, the Treasury recommendation comes on the 7th.

Mr. THORÉ. That is correct.

Senator GORE. And furthermore, that Congress could with equal justification make the permanent law in whatever form it agreed upon retroactive just as it could pass the Mills bill retroactively.

Mr. THORÉ. I think they could.

Now, I will read just this very short passage, because I think it is the gist of the thinking of the Finance Committee in 1950.

Senator BENNETT. This is a statement from——

Mr. THORÉ. It is from the report of this committee. They disposed, first, of the application of the bill to tax years 1947 and the 1948, and said that was repugnant to public policy. As to tax year 1949, the committee said, "On the other hand, the life insurance companies have certainly been on notice that a revision of the formula was being considered by the Congress for the year 1949, at least since October 19, 1949, the date the joint resolution 371 was introduced in the House. This date is over 2½ months before the end of the calendar year, and 5 months before the due date for filing 1949 returns."

Now, there was one other feature that I would like to point out to you in connection with this resolution.

As it was introduced in the House it provided a formula for determining the credit for reserve interest. This was an amendment to the 1942 law. It provided a formula which gave the companies a flat 92 percent credit for reserves and other contract liabilities, the credit you have been talking about here in these hearings.

When House Joint Resolution 37 was considered in the committee, there was opposition to the formula, in fact there was opposition over in the House to the flat 92 percent credit method. And when it got over here in this committee, which was after the taxable event, the Finance Committee introduced a new formula in this bill, different substantially from the one in the bill, and, different in its tax application.

I would like to tell you what the difference was in revenue result. The total revenue to be expected under the bill as it passed the House was $51 million.

Senator KERR. For 1949?

Mr. THORÉ. For the tax year 1949. The change made in that formula over here, which was to adopt the industry averaging method, which method has been so violently attacked here by the other witness who preceded me, reduced the overall tax burden to $42 million.

So there was a reduction here of $0 million, or approximately 18 percent of the tax.

So in this situation you have an overall increase over the 1942 law. But you have a complete change in the legislation from the time it left the House and the time it got over here. This change was a reduction in the tax.

The fact that——

Senator KERR. You mean the time it got out of here?

Mr. THORÉ. The time it got out of here. For practical purposes you rewrote the formula over here. And therefore——

Senator ANDERSON. Do you regard that as a precedent for granting a retroactive tax reduction?

Mr. THORÉ. Yes; I think it is important in connection with what we are talking about here, because for all practical purposes the bill that was passed first came to light after the taxable year, after the taxable event.

I am speaking now of the content of the bill, not the bill itself.

Senator ANDERSON. The revision was made.

Mr. THORÉ. Yes; it was so revised that it was for all practical purposes a new bill, and it was done in the Senate Finance Committee. It was changed after the taxable event.

So we think it is a precedent. And you can place your own interpretation on it.

Senator ANDERSON. What was the net result, was it to increase or decrease taxes over the previous law?

Mr. THORÉ. The net result was to increase the tax over the previous law.

Senator ANDERSON. Wasn't that some kind of a retroactive tax reduction? This is an increase.

Mr. THORÉ. Well, I think the 1950 law involves both an increase and decrease, the bill before you now involves a decrease.

Senator ANDERSON. You mean one House had a rate higher than the other. Have you got a precedent of a retroactive tax reduction?

Mr. THORÉ. Not in the form that you are requesting an answer. But I think that this is definitely a precedent for retroactive action.

Senator ANDERSON. Tax increase.

Mr. THORÉ. A decrease. I am not making it clear——

Senator ANDERSON. Yes, you are, but I do not know how you can call an increase a decrease. Did it increase the tax?

Mr. THORÉ. Overall?

Senator ANDERSON. Yes, and how is there a decrease? The Houses vary, sure, one may suggest that we increase it $100 million and the other suggest that we increase it $20 million, the fact that it is an increase is what is important, not what you do to the full amount proposed by the House.

Mr. THORÉ. It seems to us that the important thing is what the taxpayers knew about the situation during the taxable event. The taxpayers in the case of the 1950 law did not know the terms of the bill that was eventually adopted in the Senate until after the taxable event.

Senator ANDERSON. But he was not financially damaged, he was financially helped.

Mr. THORÉ. He was helped; that is right.

Senator KERR. That is right; he was helped as compared to what his situation would have been had the bill passed the House.

Mr. THORÉ. That is right.

Senator KERR. You have been reminded here that actions of the House are not final until concurred in by the Senate.

Mr. THORÉ. That I well recognize.

Senator KERR. As I understand it, the 1942 act for all intents and purposes was in effect in 1949.

Mr. THORÉ. That is right.

Senator KERR. And it was in effect when 1949 came to a close.

Mr. THORÉ. That is right.

Senator KERR. And it was in effect when the taxable—when the dates for paying the tax on 1949 arrived.

Mr. THORÉ. That is correct.

Senator KERR. And had the companies been controlled, and had they acted on the basis of the law that was in effect throughout the year, and up to and including the date of paying the taxes, they would have been in one position.

Mr. THORÉ. They would have paid no taxes.

Senator KERR. I say, they would have been in one position. But the Congress saw fit in April of 1950 to take action which in effect changed the situation of the companies, and put them in a different situation than they would have been had the Congress let them remain under the law as it was in effect during the taxable year and until the taxes were due.

Mr. THORÉ. Correct.

Senator KERR. And you take the position that if the Congress can take an action to change you to your worsening, that they might even have authority to change you to your better.

Mr. THORÉ. Correct, and I think they did that later on, in 1956.

Senator KERR. Now, when did the 1956 formula go into effect? Did it not cover 1955?

Mr. THORÉ. It went into effect in 1956, and it covered tax year 1955.

Senator KERR. Now, did it get more taxes——

Senator ANDERSON. Was it passed the middle of 1956 to cover that taxable year?

Mr. THORÉ. There are two steps in this.

First, the 1955 law, which was the Mills law, was passed in the Senate after the tax year.

Senator KERR. Passed in 1956.

Mr. THORNÉ. In 1956.

Senator KERR. It fixed the amount of tax due for 1955.

Mr. THORÉ. Yes, and then in the summer of 1956 this committee extended it to cover tax year 1956.

Senator KERR. That is what I remember.

Now, when they passed the law which eventually determined the liability for 1955, the change made was from the 1942 formula, was it not?

Mr. THORÉ. That is correct.

Senator KERR. Had the bill—which was not called the Mills bill at the time, but which was identical in language to which we now refer to as the Mills bill—when that came before us for action in 1956 to determine the 1955 tax, had it not been enacted your liability would have been under the 1942 law.

Mr. THORÉ. That is correct.

Senator KERR. Now, would the total tax have been more or less under the 1942 law or under the bill that we passed?

Mr. THORÉ. More.

Senator KERR. It would have been more under the 1942 law.

Mr. THORÉ. Just as it is here, only different in dollar amount.

Senator KERR. But the difference would have been a good deal less than it would be for 1957? My recollection was that the bill we passed got about as much revenue as the 1942 act got.

Mr. THORÉ. Actually, it did not. I can give you the figures.

Senator KERR. I would like to have them.

Mr. THORÉ. The overall revenue on the Mills law for tax year 1955 was $37 million less than would have been produced under the 1942 law.

Senator KERR. But at the time the committee had before it, as I recall, detailed information as to the application of the law to various groups of companies and to various sizes of companies as between stock companies and mutual companies and as between small companies and big companies—I think you—

Mr. THORÉ. Senator, my recollection is that a very thorough consideration was given over in the House, a voluminous record, which was available to you here, but your hearings were not as complete.

Senator KERR. I thought they were very complete, they not only included a very rigid cross-examination of the witnesses by me, but some very stern lectures from some of those witnesses to me.

Mr. THORÉ. I was there and I recall your able cross-examination.

Senator GORE. Upon a few rare occasions the distinguished Senator from Oklahoma has lectured a little too.

Senator BENNETT. What was the date of the passage of the first action in 1956, which action made the law apply to 1955?

Mr. THORÉ. It was reported favorably by the Senate Finance Committee on February 23, 1956. And I do not have the date of passage, but it was in time.

Senator KERR. It was prior to March 15.

Mr. THORÉ. Yes; because the President signed it on March 14. There was much emphasis on getting it through and getting it signed, and the President actually signed it on March 14.

Senator KERR. Thank you.

Mr. THORÉ. Gentlmen, that is the burden of the factual information I bring to you.

And on that basis we feel there is precedent for taking action on H. R. 12220.

Thank you for your patience in hearing my presentation.

Senator BENNETT. Mr. Chairman, may I ask if the entire statement is going to be submitted by the witness for the record. I assume that he has been interpolating and changing it.

Mr. THORÉ. Yes.

(The prepared statement referred to follows:)

STATEMENT OF

EUGENE M. THORÉ

VICE PRESIDENT AND GENERAL COUNSEL,

LIFE INSURANCE ASSOCIATION OF AMERICA,

WASHINGTON OFFICE

The question arose at the hearings yesterday whether the enactment of H. R. 10021, the bill being considered, would constitute retroactive action, since the taxable year 1957 has already come to an end. We agree, of course, that the enactment of any tax law after the taxable year has ended involves an element of retroactivity, which should be carefully studied by your committee. The basic question to be considered is whether such retroactive action is repugnant to sound public policy. In deciding this question, it woud appear appropriate to examine the facts in each situation and square them with the established legislative precedent.

Now first as to the facts in connection with H. R. 10021. Early in the summer of 1957, when it seemed to us that the Treasury would not produce a new plan in time to permit Congress to have hearings thereon and pass legislation before the end of the session, we approached the Honorable Wilbur Mills, then chairman of a subcommittee of the House Ways and Means Committee, which had jurisdiction over this matter. We asked that he introduce a bill extending the Mills formula to apply to tax year 1957. Mr. Mills was willing to introduce such a bill, provided the Treasury would take a favorable position on such an extension. At that time, it was still expected that the Treasury would offer a proposal for permanent legislation in the fall, and consequently Mr. Mills felt that an expression of the Treasury's attitude toward an extension was essential to the consideration of an extension bill.

In July, 1 week after Secretary Anderson took office, we asked the Secretary to consider the matter and communicate his position to the chairman of the Ways and Means Committee. At a conference with Secretary Anderson shortly thereafter, he stated that he was too new in his position to pass on the merits of an extension and that other duties were so heavy he would not be able to give the matter consideration at the current session of the Congress. He pointed out that the Treasury still had hope of bringing forth a new proposal for the taxation of life-insurance companies before the next session of Congress. And he further stated that he was informed that, if an extension became necessary, the same result could be obtained by the passage of a law at the next session prior to March 15, 1958, and that such practices had been followed at least twice before in the area of life-insurance company income legislation. He assured us that he would give the matter consideration and make his position known prior to the next session of the Congress.

Following these conferences with the Secretary of the Treasury, we again consulted Congressman Mills and he in turn conferred with the then chairman of the Ways and Means Committee. Following these conferences, we were informed that under all the circumstances, the chairman of the Ways and Means Committee was opposed to bringing an extension bill before his committee during the current session of the Congress; but would consider such legislation at the beginning of the next session, when it was expected that Secretary Anderson would submit his recommendation.

Under date of November 20, 1957, we addressed a letter to the Secretary of the Treasury again urging that the Treasury make known its position with respect to an extension of the Mills formula at the earliest possible date. On January 10, 1958, the Secretary addressed correspondence to the chairman of the Ways and Means Committee and the chairman of the Senate Finance Committee agreeing to an extension of the Mills formula. Immediately upon receipt of this letter, Congressman Mills introduced H. R. 10021 in the House. The bill was reported favorably on January 23 and passed the House on January 30. It was considered by this committee in executive session on February 21.

These are the facts which bring us up to these hearings. The point we would like to stress in particular is that every effort was made by the industry to bring about the introduction and passage of an extension bill during the 1957

session. There were two principal complications. First, there was still some hope that the Treasury would bring out its proposal for permanent legislation in time to give it consideration prior to the March 15, 1958, return date. Second, Secretary Humphrey was leaving office and Secretary Anderson was just taking office and the latter who was completely unfamiliar with the subject, felt that he should have additional time to study it before making a recommendation.

Now as to precedents. The factual situation I have described is practically on all fours with the facts surrounding the enactment of the 1950 law applicable to the taxation of life-insurance companies. On October 10, 1949, the then Secretary of the Treasury recommended that stopgap legislation be enacted for tax years 1948 and 1949, in the form of an amendment to the 1942 law which was producing no revenue. On the same day, the chairman of the Ways and Means Committee introduced House Joint Resolution 371 carrying out the Treasury's recommendation.

The Ways and Means Committee took no action on this resolution, however, until January 24, 1950. On that date, they reported out the resolution applicable to tax years 1947, 1948, and 1949. From the standpoint of our consideration here today, it is important to note that the committee substituted a new formula for the one contained in the original bill.

There were hearings on House Joint Resolution 371 in its amended form before the Senate Finance Committee on March 16 and 20, 1950. A large part of the testimony at the hearings was devoted to the question of retroactivity. The life-insurance organizations did not object to the retroactive features of the resolution, but there was objection from individual company witnesses. The opposition of these witnesses was directed mainly to the application of the resolution to tax years 1947 and 1948. It was generally conceded, however, that the application of the resolution to tax year 1949 was not opposed to fundamental public policy, even though tax year 1949 had ended. The Senate Finance Committee reported the resolution favorably by a unanimous vote on April 10, 1950, but restricted its application to tax years 1949 and, by amendment, added year 1950. In this form it passed the Senate on April 13, 1950.

In discussing the application of this resolution to tax year 1949, the Senate Finance Committee report, after condemning the retroactive application to tax years 1947 and 1948, had this to say, about 1949:

"On the other hand, the life-insurance companies have certainly been on notice that a revision of the formula was being considered by the Congress for the year 1949, at least since October 10, 1949, the date House Joint Resolution 371 was introduced in the House. This date is over 2½ months before the end of the calendar year and 5 months before the due date for filing 1949 returns."

Now, applying this precedent to H. R. 10021, may I point out that, beginning in July 1957, there were conferences with both the Treasury and the chairman of the Ways and Means Committee subcommittee. As in the case of the House Joint Resolution 371, the life-insurance companies were on notice that efforts were being made to extend the Mills formula to cover tax year 1957. The only difference I can detect is that, in the case of House Joint Resolution 371, a bill was introduced during the tax year, and in the current situation the bill was not introduced until after the tax year. On the other hand, the formula in House Joint Resolution 371 was replaced on January 24, 1950, after the end of the tax year. Thus, in 1949, the industry did not have notice of the actual terms of the tax formula until after the end of the tax year, although it had advocated such a formula during the taxable year.

As in the case of the bill now before you, the formula in the 1950 law was recommended by the industry and was supported by the Treasury. But, from a revenue standpoint, the situation was the reverse. House Joint Resolution 371 produced $42 million of revenue, whereas the 1942 law produced practically no revenue for tax year 1949, whereas H. R. 10021 would produce less revenue than the 1942 law. On the other hand, it should be noted that the change in the resolution adopted by the Finance Committee on January 24, 1950, produced a reduction in the tax of $9 million as compared with the formula in the bill at the time it passed the House. So, it seems clear from the record that this committee's action in 1950 is a precedent for the enactment of H. R. 10021.

In 1950, for all practical purposes, the bill was written after the close of the tax year. Moreover, in the case of H. R. 10021, we are considering legislation which had been enacted twice before to cover tax years 1955 and 1956. The course of events preceding the introduction of the bill in January 1958 clearly falls within the text I have quoted from the committee's report on the 1950 law.

Again, in 1956, another precedent was created. H. R. 7201, the original Mills bill, passed the House on July 18, 1955. Hearings were held in the Senate on July 25, 1955, but action was deferred until 1956. The bill was reported favorably by the Senate Finance Committee on February 23, 1956, which was after the end of tax year 1955 to which the bill applied. The situation differs from the one before you today in that the bill was introduced during the tax year. However, as in the case of the 1950 law, substantial amendments were made by the Senate Finance Committee after the end of the year. These amendments increased the revenue under the bill approximately $28 million. The overall revenue, however, was $37 million less than that which would have been produced by the 1942 law, a situation similar to the one you are considering, although different in the dollars involved. No question of retroactivity was raised and, presumably, the committee relied on the 1950 precedent.

These two precedents of this committee established that, where legislation is considered and enacted shortly after the end of a tax year, this committee did not consider such action to be opposed to public policy on the ground that the taxpayers involved were on notice that the legislation was being considered for the tax year in question. There can be no question that the life-insurance companies knew that an extension of the Mills formula was being actively advanced and, on the basis of past experience, they had reason to believe that, if permanent legislation were not adopted, stopgap legislation would be considered between January 1 and the March 15, 1958, return date.

Senator GORE. If the Congress should request, and the Internal Revenue Commissioner should assent to the request, a 30-day extension of the filing date for insurance companies, it would be possible, would it not, for the committee to consider this proposal in the light of the Treasury recommendations without prejudice to the issue or the companies involved.

Mr. THORÉ. May I clear up one part of your question? Do you have in mind that, out of this procedure, there is some hope for adopting permanent legislation, say, within this session of Congress?

Senator GORE. That possibility was not contemplated in my question.

Mr. THORÉ. Is your question merely to delay action, so you can get more information?

Senator GORE. Let me restate my question. If the committee should request, and the Internal Revenue assents to the request, a 30-day extension of filing date by insurance companies, would it not then be possible for the committee to act upon the proposal in the light of the recommendation of the Treasury as to permanent legislation which is now promised for April 7 without prejudice to the issue or the taxpayers involved?

Mr. THORÉ. The taxpayer would not be prejudiced financially. Of course, it further complicates their problem of doing business without knowing what their tax liabilities are.

Senator GORE. Thank you.

The CHAIRMAN. Are there any further questions?

Thank you very much.

The committee will adjourn until tomorrow morning at 10 o'clock, when there will be an executive session.

(The following letter was subsequently received for the record:)

WOMBLE, CARLYLE, SANDRIDGE & RICE,
Winston-Salem, N. C., February 28, 1958.

Hon. SAM J. ERVIN, JR.,
Senate Office Building, Washington, D. C.

DEAR SENATOR: Our firm is general counsel for Security Life & Trust Co., a North Carolina insurance company with its home office in Winston-Salem. I have a copy of the letter written by Tully Blair, president of the company, to you under date of February 25, 1958.

During the period of low interest rates, the formula set out in the act of 1942 was unfair to the Government and to remedy the situation, as I understand, stopgap legislation was enacted. The formula contained in the act referred to by Mr. Blair as the Mills law is, as I understand, satisfactory to the Treasury and is generally acceptable to the insurance companies as a permanent formula except as it affects pension trusts, annuities, and some other items. In this field, insurance companies are in competition with trust companies and suffer a disadvantage in the absence of some changes to take care of these situations.

I understand that unless the Mills law which was in effect during the years 1955 and 1956 is extended prior to March 15 to cover 1957, the companies will be taxed under the 1942 act. In view of the interest rates prevailing in 1957, an unfair tax burden will, in that event, be cast upon the insurance companies and ultimately the policyholders.

A hearing before the Finance Committee of the Senate is scheduled for next Tuesday, March 4. I know you are not a member of the Finance Committee, but all of us here interested in this matter hope that you may see fit to use your influence to secure passage by the Senate of the bill which has already been passed by the House extending the formula under which the tax was fixed for 1955 and 1956 to 1957. Permanent legislation probably ought to have been presented prior to this time but since this has not been done, injustice ought not to be imposed by allowing the 1942 act to come back into effect.

With kindest personal regards, I am

Sincerely yours,

B. S. WOMBLE.

(Whereupon, at 1 p. m., the committee adjourned to reconvene at 10 a. m., Friday, March 7, 1958.)

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