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FEDERAL INCOME TAX

A. How is the allocation of income tax by line of business handled? What problems occur when a line shows an operating loss and how may they be solved? What special treatment is accorded pension plan reserves?

B. How may the tax liability be estimated for annual statement purposes? For interim statement purposes?

C. Has it been found desirable to employ special tax consultants? If so, how much is the consultant asked to do? Who or what official or department within the company is responsible for the preparation of the tax return and why?

MR. GLENN O. HEAD: The allocation of federal income tax is of interest to the United States Life for more than the allocation by line of business. We must also allocate by foreign country in order to calculate foreign tax credits and also between participating and nonparticipating business. The amount of foreign tax credit received on the U.S. income tax depends on the allocation by country, and therefore this allocation affects the company's financial results. The allocation must satisfy the Internal Revenue Department, the New York Insurance Department, and ourselves.

We felt we should use essentially the same method for allocating the income tax whether for calculating foreign tax credits, by line of business, or between participating and nonparticipating.

In order to avoid a sharp change in the amount of tax that is charged against a given line of business arising from a small change in the full amount of tax being paid, we allocate the tax in proportion to the taxable income for each line of business which has been calculated using the tax form and prorating the $250,000 maximum carry-back from Phase 2 to Phase 1 in proportion to the Phase 1 taxable income. No line of business gets a tax credit. The advantage of this method is that a change in any of the factors will produce only a small change in the amount of tax allocated by department or by line.

As to section B, our tax liability is calculated using the tax form at the year end and the company's share is projected based on the prior year's calculations. This projection is used as the estimate for interim statements.

As to section C, the United States Life has hired outside tax consultants. The actuarial department, which is the central point in the company on income tax matters, prepares the income tax form, but it feels inadequate to handle such things as qualifications for capital gains treatment. The outside counsel comes in probably two or three times a year to review special problems, such as nationalization in Cuba and the tax implications of strengthening the reserves to the net level basis.

MR. WILLIAM L. BARBER: In allocating the federal income tax by line of business the Union Mutual sets up fund accounts on each line of business. We determine, or attempt to determine, what the tax would be for each line of business if it were standing on its own. We also give no tax credit for any line of business, and of course the tax as derived by line of business does not equal the tax for the company as a whole.

The problem as regards pension plans is what to do with the savings from the federal income tax as the result of the one-third, two-thirds, and three-thirds situation in the tax blank. The savings could be incorporated into the dividend formula, or a single payment to the trustees at the end of each year could be made. The Union Mutual chose the latter approach since our reserves are in such a form that they are separated by trust. We had to first determine what the total savings were for all qualified plans and then distribute these savings to each plan according to the reserve on that plan.

MR. J. STANLEY HILL: We feel that a mutual company of medium or smaller size, although it is going to be thrown into a Phase 2 situation occasionally by mortality fluctuations, should attempt to plan its operation so that it does not incur a Phase 2 tax chronically and so that when it does incur one it should be a relatively small one. That being so, since the bulk of the tax arises from Phase 1, it seems quite proper to distribute it in accordance with investment income except for the pension line.

On the question of estimating tax liability for annual statement purposes, the Minnesota Mutual currently has under development a modification of its statement program which will produce this as a by-product. The program has been refined for by-products and special internal statements that require subdivision of the input to a point where about two thousand items of input are needed to produce the first fourteen pages of the statement and the by-products.

A comment on the current status of the "tax-exempt project" might be of interest. One company has filed its claim for refund, so if the claim is not rejected by the Treasury they will be in a position to start suit about the middle of this year. Another claim for refund has been prepared and is now ready for filing. Three companies, all in the billion dollar or multi-billion dollar in-force class, have all paid one or more, or filed one or more returns on a basis which treats tax-exempts and intercorporate dividends at least as favorably as the committee believes that they should be treated. These companies no doubt will be assessed a deficiency when they are audited. At that point they, of course, will have a choice as to whether to pay the deficiency or go to the Tax Court. It is presumed that each of them would pay their deficiency and file a claim for refund.

MR. GRAHAM C. THOMPSON: Of 25 companies whose 1960 statements I have looked over, 12 charged their entire income tax to investment only; 10 charged it to the insurance account only; and 3 charged it partly to insurance and partly to investment. One of the latter had a large negative credit in the Accident and Health line.