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FEDERAL INCOME TAX TOPICS

A. For smaller companies with few qualified technical personnel, what is the best approach to furnish adequate guidance to the company in connection with federal income taxes and the preparation of the return?
B. What methods and records systems are being used to furnish the tax information required by the federal return other than those required to produce the annual statement?

MR. GENE P. ARCHER: The problem is to determine the most economical way of acquiring adequate tax counseling. It must be met on an individual company basis. Of the two alternatives—hiring competent tax executives or retaining outside professional tax counsel—at the American Hospital and Life we prefer to supplement the tax knowledge of our own executives with that of outside professional counsel. Many of the large companies also follow this practice.

MR. HERALD H. HUGHES, JR.: I would caution against any decision made solely because of the tax consequences. While important, it should not be the sole basis of the decision.

In determining depreciation schedules, National Standard Life uses broad groupings of objects such as IBM equipment and desk calculators, furniture and fixtures. Our real estate is kept track of parcel by parcel.

We amended our 1958 and 1959 returns omitting the nonparticipating deduction under 809 (d) (2) from our calculations. This reduced our contribution to policyholders' surplus. However, we have just been examined and the treasury agent has indicated he will not allow us to fail to take the nonparticipating deduction. He referred us to Treasury Regulation 1.815-4 as a basis for his tentative decision.

MR. JAMES A. LIVINGSTON, JR.: The policyholders' surplus account is limited to the greatest of 15% of life reserves, 25% of the reserve increase since 1958 or 15% of premium income for the taxable year; it is possible for a company to experience a large increase in federal income tax if this limitation is exceeded. This event is unlikely in most large established companies because 15% of life reserves provides a rather high limit to the policyholders' surplus account, but it is frequently possible for a new or small company to exceed the limit in cases where Phase 2 income is large relative to the reserve increase. In such companies a projection of the policyholders' surplus account should be made to discover if the statutory limitation on this account will be exceeded in any year in the foreseeable future. It is quite possible for federal income tax to jump four or five hundred percent in such an event, and sudden tax increases of this magnitude should not be allowed to occur without warning.

MR. ARCHER: With regard to section B, we found, with few exceptions, that the records necessary to prepare financial statements for our company were adequate for preparing our tax returns. One obvious exception is the preparation of data necessary to calculate the nonparticipating deduction. We also have to furnish data concerning expense accounts which were not required before.

Of course, the problem stems from the difference in orientation between examiners and revenue agents. The one group places primary emphasis on admitted assets and liabilities, and the other is more interested in income and expense items.

We have learned that it is not satisfactory to simply reconcile individual items in the tax return, but an over-all reconcilement including totals must also be prepared.