**TRANSACTIONS OF SOCIETY OF ACTUARIES
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REPORTS ON TOPICS OF CURRENT INTEREST

AMERICAN ACADEMY OF ACTUARIES

At the Society meeting a year ago, we reported that a bill to charter the Academy of Actuaries had been introduced in the United States Congress and that it had passed the Senate but failed to pass the House because of the pressures and because it was introduced there rather late in the session.

At that time we were very hopeful that by getting in early in 1965 our bill would pass quickly. We started very early in January. We were told that, until the Civil Rights Bill was out of the way, the House Judiciary Committee would not even consider our bill, so it was August before we were able to have any serious talks with the members of the subcommittee considering the bill.

The Senate passed our bill again very promptly, as it had the previous year. The House Judiciary Committee kept deferring us. On September 14, the President vetoed a bill that would have provided for a federal charter for another organization—a youth council organization. He stated that federal charters should not be granted without clearly established standards and criteria with regard to eligibility.

I think that we were caught in a discussion that is going on in Washington regarding whether or not Congress should charter organizations. It is the feeling of many congressmen that this is a rather trivial thing to pass through the halls of Congress, that it should be set up as an administrative procedure, and there are recommendations currently being made that such an administrative procedure be set up in one of the administrative offices. We have a copy, in fact, of the recommendation that this be done.

We were told, consequently, that hearings would be required and that next spring or early next year, probably in January, would be the first time that such hearings could be held by the House Judiciary Committee on our application for a charter.

Our steering group felt that we should not wait until next year but should proceed with the organization of the Academy on an unincorporated basis, that we should continue to seek a federal charter next year, and that, if we do not obtain that charter fairly early next year, we should then incorporate in one of the states. We have investigated and find that we can incorporate rather quickly through the Secretary of State's office in one of several states. Consequently, yesterday the organizers of the group met and held an organization meeting at which Articles of Association and Bylaws were adopted and a Board of Directors and Officers for the new Academy were elected.

The Directors then met and authorized the president to appoint certain committees and elected the Admissions Committee, which must be elected by the Board.

For your information, I was elected president, as Mr. Henningsen has mentioned. The other officers are Thomas E. Murrin, president-elect —he is currently president of the Casualty Actuarial Society; John H. Miller, Laurence H. Longley-Cook, H. Raymond Strong, and Frank J. Gadient, vice presidents (you will recognize that each of these is in effect representing one of the four existing actuarial bodies); Robert E. Bruce, treasurer; and George M. Bryce, secretary.

The Committees that were authorized were the Nominating Committee, Professional Conduct Committee, Education and Examination Committee, Public Relations Committee, and Accreditation Committee.

The Board of Directors consists of the following persons in addition to the officers:

Edward D. Brown, Jr.	Frank Harwayne	Daniel J. McNamara
George B. Buck, Jr.	Victor E. Henningsen	Wendell A. Milliman
Donald F. Campbell	Walter Klem	Joseph Musher
Mary M. Cusic	William Leslie, Jr.	Robert J. Myers
Gilbert W. Fitzhugh	Norton E. Masterson	Walter L. Rugland
William E. Groves	Allen L. Mayerson	Andrew C. Webster

We anticipate that within a week or so an announcement will be sent to the members of the existing organizations, including, of course, the Fellows and Associates of this Society.

The top-ranking level of members of each group, that is, the Fellows of this Society and of the other three organizations, will automatically be enrolled unless they notify the secretary within sixty days that they prefer not to be a member.

We have not set our dues yet, and we realize that this could be of concern and perhaps affect the decision of some people on the question of membership. We discussed this, and, although we have not taken official action, I think it was the general feeling of the group that we would try to announce dues before the end of this year. Certainly we would not expect a person who had indicated his acceptance—that is, had not indicated that he chose not to accept membership—to pay dues if he resigned promptly when the dues structure was announced.

I think that I will encourage all of you to accept membership with the understanding that, if you feel that you want to resign when the dues structure is announced, you will not be expected to pay dues for the first year. In other words, we will probably set up the dues so that they are not payable until after that date or waive them for those that promptly resign.

With regard to Associates, we hope to have an application blank ready very soon which can be mailed to Associates so that they can make application, and the machinery to process those applications will be set up as soon as possible.

With regard to persons who are not members of one of the four existing bodies at the present time, we feel that we should defer accepting applications from that group for a short time in order to give our Membership Committee time to prepare proper procedures and to get an organization set up that can handle those applications when they come in.

Also, our Membership Committee feels very strongly that, when a person who is not a member of one of the existing organizations applies for membership, he should commit himself at that time to abide by our Code of Professional Conduct. The Professional Conduct Committee was appointed yesterday, and, although there has been some preliminary work done on the Code, we feel that we should not accept applications for membership from nonmembers until the Professional Code is ready to send to them so they will know what they are agreeing to.

Moreover, it is necessary that we have an examination for those people who are questionable. The members of the Examination Committee have already given some thought to what form this examination might take, but, until there is an examination ready, they cannot act on such applications. They could, of course, accept some applicants who appeared completely satisfactory from the standpoint of experience and education but I think that it will be early next year before we will be able to accept applications from persons who are not members of one of the four existing organizations. In the interim we will have time to process the Associate group, to decide on examination procedures, and to adopt a Professional Conduct Code. Thank you very much.

HENRY F. ROOD

FEDERAL TAX DEVELOPMENTS IN THE UNITED STATES

It has been suggested that you would be interested in a short rundown of a few recent federal tax developments or, rather, prospective developments affecting life insurance or insured pensions.

If what I have to say seems to take on the characteristics of an "on the other hand" type of presentation, please allow for the fact that a pessimistic forecast of the prospects for a favorable ruling in some tax area may be taken by those in charge of its outcome as a confession of weakness in our proposing a favorable ruling, whereas too optimistic a forecast may be taken by those in charge of that outcome as requiring rebuttal. Either way, it is necessary for me to straddle a little more than I like to do, except where the situation is reasonably clear.

Four issues of importance on which tax rulings are or may be in prospect are: (1) the tax treatment of discount allowed on life insurance premiums paid in advance; (2) the income taxation of employee group term life insurance in excess of $50,000; (3) revision of the imputed income factors contained in the so-called PS 58 (more accurately, Revenue Ruling 55-747) as they apply to the valuation of incidental life insurance protection provided under qualified pension and profit-sharing plans; and (4) the estate tax effect of assignments of group life insurance certificates.

Discount on Life Insurance Premiums Paid in Advance

In November, 1964, and more formally early this year, the Internal Revenue Service reaffirmed a quarter-century-old tax ruling which held that the allowance of discount on the payment of premiums in advance does not create a taxable income situation for the premium payer with respect to the amount of that discount. A still more recent Revenue Ruling 65-24 of July, 1965, reversed the old rulings and held that any discount allowed for the payment of premiums in advance *is* taxable to the premium payer, at least from now on.

Rumor has it that this tax-ruling reversal was triggered by overzealous promotion by some life insurance companies of the federal income tax advantages of investing in prepaid life insurance and annuity premiums. Personally, I do not see how advantage can be taken of a favorable tax situation for life insurance policyholders, unless the policyholders are told that the favorable situation exists. So I, for one, do not join in any criticism of life insurance companies for bringing the situation to the attention of their customers. I do question the judgment of some who went so far as to use premium-notice stuffers indiscriminately and to conduct widespread promotional campaigns. We have heard that one of these premium-notice stuffers went to the Commissioner of Internal Revenue, who reacted to a tax-avoidance campaign just as you would think he would.

But whatever did trigger the reversal of policy position by the Internal Revenue Service, the hard fact of the matter is that the reversal is an accomplished fact. This then brings up the question of whether the reversal can itself be reversed.

I do not propose to give you a rundown of the legal arguments—since I am not a lawyer—but I can bring to you the news that so far officials in Washington seem wholly unimpressed with arguments that they were wrong in issuing this latest ruling declaring premium discounts taxable. This is not, I know, good news to those of you who are associated with life insurance companies. If the ruling stands up, as it appears likely to do, we will just have to make the best of it. However, some people point out that it is anomalous to tax the discount for, say, the advance payment of the last five premiums of a 15-year-old 20-payment life policy, and not to tax the price allowance inherent in a charge made for converting the 15-year-old 20-payment life policy to a paid-up 15-payment life policy. This is true. There are two ways, however, not just one, to remove this tax anomaly, one of which would be favorable to the taxpayer and the other one most unfavorable. So I think that the tax-anomaly argument can be carried too far, and I suggest not using it.

If we assume that the income taxation of discount on advance premiums will stand up, then there are several major details still to be resolved. First, is the discount on any given premium payment taxable each year as it accrues, or is it taxable just once as it is applied as the premium itself falls due or is withdrawn? The answer to this question is important, not only because it governs the internal procedures a life insurance company must set up to make the proper tax reports but also because it affects the total amount of taxable income under the expected tax "grandfathering" of discount earned to date, but not that earned in the future, on premiums paid in advance before the new ruling came out. Second, if the discount is taxable as it accrues, rather than as it is applied, what tax allowance will be made for any penalty which would be imposed for withdrawal of an advance premium before it falls due? We have put these two basic questions to Washington authorities, but so far we have received no answers. We are under the impression that they are having a hard time deciding themselves what is the best answer.

So, on the taxation of discount on advance premium issue, the principal hard news is that there appears to be no disposition on the part of the tax authorities to reverse themselves again on the basic issues involved. We will have to wait until more regulation details are available to see if there will be any exceptions to the new principle that discount on premiums paid in advance is taxable to the premium payer.

Group Term Life Insurance Tax Regulations

Last December, the Internal Revenue Service promulgated a standard table of one-year term life insurance factors for use in imputing taxable income to employees insured for more than $50,000. By and large, these factors are realistic ones in that they follow closely, age by age, average net group term life insurance costs in the United States. No other tax instructions of any importance have so far been issued, even though proposed regulations were published some fifteen months ago.

Many people have asked when final regulations will actually appear, because without them no one knows what the fine points of the ground rules are for taxing employer-financed group term life insurance. We have reason to believe that they will appear by the end of this year; but that is just what we said this time last year, so don't count on it.

What is holding up these regulations is apparently some basic disagreement within high Washington circles on several rather fundamental questions—particularly the question of just what "employee group" life insurance is for the purposes of a federal tax law specifically excluding the first $50,000 of insurance. There are two parts to this question of definition. First, must a master group policy be used, or may a group of individual life insurance policies be used? We think that the law is designed to permit the use of a group of individual life insurance policies in place of a master policy, since their use has long been customary in the field of so-called baby-group insurance. Second, must certain commonly accepted attributes of group life insurance, such as the existence of a schedule of amounts of insurance, be present? On this, it is easy to write up a list of commonly accepted attributes of group life insurance but not a list which does not have important exceptions. So you can see why the tax authorities are having trouble.

As I have indicated, we will just have to wait for the final regulations to appear to discover the answer to these and other important questions.

Revisions of the Imputed Income Factors for Taxing Life Insurance under Individual Policy Pension Trusts

In the United States, if an employer buys life insurance for his employees by way of an individual policy pension trust plan rather than through a group life insurance plan, the employees not only fail to have the benefit of the new $50,000 group term life insurance exclusion but they will be required to pay taxes on income imputed on the pure life insurance protection at rates higher than those for taxable group life insurance. The same tax disadvantage applies in the case of life insurance incidentally included with so-called tax-sheltered annuities and in the case of "split-dollar" life insurance arrangements.

These are controlling legislative reasons why it is virtually impossible to remove the tax discrimination against non–group insurance forms of life insurance which arises from the fact that the $50,000 group term life insurance exclusion does not apply to these other forms of employer-financed life insurance. However, there does not seem to us to be any good reason why the table of one-year term insurance rates used to attribute taxable income to employees on the pure life insurance protection that is taxable should be less favorable for these other forms of life insurance than for group term life insurance.

Therefore, about five months ago the Life Insurance Association of America and the American Life Convention filed a memorandum with the Internal Revenue Service, arguing that the table of one-year term insurance rates used for taxing the life insurance element in individual policy pension trusts (PS 58 or Revenue Ruling 55-747) should be revised to make that table consistent with the new table of group term life insurance factors. Not only is this revision needed in the interest of fairness, but it would remove a tax discrimination against employees of small employers who generally are covered by pension plans which are funded by individual life insurance policies, whereas employees of medium-sized and larger employers having insured pension plans tend almost exclusively to be covered by group life insurance.

The memorandum is still pending, and we do not expect to have the issues it raises resolved until after the final group term life insurance regulations appear, which, as I have said, should be by the end of this year. Commissioner of Internal Revenue Sheldon S. Cohen did give an unfavorable prognosis of the outcome in a speech before the Federal Tax Institute of New England on April 24, 1965, but that was before our memorandum was filed and before any other case had been formally presented for using the new group term life insurance factors in determining taxable income under individual policy pension trusts, tax-sheltered annuities, and split-dollar insurance arrangements.

Estate Tax Effect of Assignment of Group Life Insurance

With the new $50,000 group term life insurance taxable income exclusion, it is clear that employer-purchased group term life insurance is largely tax-free on the pay-in side, that is, as the premiums for it are paid by the employer out of before-tax income. Not so clear, however, is whether such employer-purchased group term life insurance, if assigned to the beneficiary, is estate-tax-free on the pay-out side, when the proceeds are payable to the beneficiary. Considerable numbers of group life insurance certificates have actually been assigned to the beneficiaries, on the assumption that the estate-tax consequences are the same as those occasioned by the assignment of regular ordinary life insurance policies.

The reason for this doubt concerning the estate-tax effect of group life insurance assignments arises from doubt regarding the completeness of purported assignments. If the assignments are complete, in fact as well as in form, the tax law is reasonably clear that the estate tax is not payable. On the other hand, if the assignments are not complete, that is, if some rights are actually retained by the assignor, the proceeds of the insurance are includable in the taxable estate of the insured.

It has been argued that complete assignments are not possible, on the grounds that it is impossible to give away all of one's rights represented by a group life insurance certificate on his life; necessarily retained are the right of termination of the insurance by resignation from the employ of the employer who provides the insurance, the right to name one's own beneficiary, and the right to convert one's insurance to an individual policy upon termination of employment, either because such rights are reserved to the employee by state insurance law or because the rights are "personal." This being so, there is doubt about the tax effect of purported assignments of group life insurance certificates.

As has been reported by some of the commercial tax services, there are indications that the Internal Revenue Service is about to rule on this estate-tax issue one way or another and that, if it does rule, the likelihood is that it will hold that everything depends upon local state law with respect to whether these various incidental rights can all be given away by the insured employee. We do know that the states of Louisiana and Washington now have laws which state, indirectly, that a group term life insurance certificate may not be assigned at all in these states. In other states, the issue may have to be settled by the courts. New York State assignments have recently been questioned by the Internal Revenue Service, and a law suit is quite possible. However, lawyers tell us that they do not see how the outcome of such a law suit can fail to be favorable to the taxpayer, because there is very little to support the theory that there are any unassignable personal rights in group life insurance. A favorite example of an unassignable personal right found in law textbooks is the right to marry someone after he or she has promised to do so—you just cannot transfer this right of marriage to someone else. An employee's right to name a group life insurance beneficiary, or to convert his group life insurance on termination of employment, hardly seems in the same league as the personal right of marriage.

It seems probable, therefore, that, even if the Internal Revenue Service rules on the issue, it will do so in a way which will still throw the matter back to state determination regarding the completeness of group life insurance certificate assignments. While, as indicated, we think that state findings concerning such completeness of assignment will be favorable to the taxpayer, no one can tell yet. Meanwhile, it would seem inadvisable for any insurance company to embark on a systematic program of encouraging group life insurance certificate assignments just to avoid estate taxes.

Other Pending Federal Tax Matters

So much for these four particular tax issues. There are, of course, many other tax issues which are pending, such as those which arose from company tax audits by the IRS. I cannot give you all the details of these, and I am sure you would not want me to do so today even if I could.

ALBERT PIKE, JR.

SERVICEMEN'S GROUP LIFE INSURANCE

As most of you are probably aware, President Johnson's signature has recently enacted into law legislation establishing "a program of group life insurance which shall be provided by private insurance companies for members of the uniformed services who are on active duty," thus eliminating what at one time threatened to be another very serious encroachment upon our preserves.

Senate Bill 2127, as originally introduced, would have provided a gratuitous indemnity of $10,000 for the survivor or survivors (as defined in the bill) of each person on active duty whose death should occur while serving in a combat zone or within two years thereafter if death should be determined to have been the direct result of an injury or disease incurred while serving in a combat zone.

The sponsors of the bill contended that such legislation was necessary because (1) under existing law there were occasions when service personnel did not qualify for survivors' benefits, although there were survivors beyond the scope of the law who needed and deserved such benefits, and (2) service personnel, particularly those on or alerted for duty in a combat zone, were finding it increasingly difficult to buy private insurance without restrictive war clauses or for more than nominal amounts.

Mr. Edward Lew, of the Metropolitan, and I had the honor of being selected to represent the life insurance industry at a hearing before the Senate Finance Committee on August 11. The essence of our testimony was that improved security for the beneficiaries of servicemen could best be met by amending the present legislation rather than by the gratuitous-indemnity approach, not related to need, embodied in the proposed new law. We also commented briefly on the availability of private insurance.

That our arguments, as well as those of representatives of the Veterans Administration who had also spoken in opposition, had apparently fallen on deaf ears is evidenced by the fact that the bill was reported favorably out of committee the very next day, with a conversion right added. The bill, with a second amendment, was passed by a voice vote in the Senate on August 18 and again with a third amendment on August 19.

We had, however, been encouraged to believe that the Veterans Administration and the Veterans Affairs Committee of the House would be sympathetic toward and would, indeed, welcome a privately sponsored group life insurance plan as an alternative. Accordingly, a number of representatives of life insurance companies met in New York on August 20, at which time it was decided to draft and present to the House Committee a group life proposal along the lines of the existing plan for civilian employees of the federal government. This plan was discussed with the staff of the House Committee the following week and was favorably received. Mr. Lew and I also had the privilege and pleasure of speaking on its behalf before the Insurance Subcommittee of the House Committee on September 8.

The happy consequence of all these industry efforts was the introduction and passage of House Bill 10873, its adoption by the Senate, with a minor technical amendment concurred in by the House, and its quick signing into law.

The Act provides that each eligible serviceman, that is, a serviceman on active duty, shall be automatically insured for $10,000 unless he affirmatively elects either (*a*) to take himself out of the program or (*b*) to be insured for only $5,000. Since there are currently approximately 2,800,000 servicemen on active duty, this means that a potential volume of $28 billion is indicated, although that volume will probably be somewhat smaller, depending upon how many persons in service elect either not to become insured or to become insured for only $5,000.

An initial monthly premium of 20 cents per thousand is contemplated, with this cost to be adjusted in the future (hopefully downward) as experience dictates. Premiums will be deducted from pay by the Department of Defense and remitted to the Veterans Administration. These deductions, it is contemplated, will cover administrative expenses as well as the risk involved. Incidentally, the premium rate indicated is supposed to cover only the normal risk with the extra hazard cost to be paid by the United States government after an actuarial determination. With casualties at present levels, this extra annual cost is estimated at $4 million.

The serviceman may designate any person as beneficiary, but in the absence of a designation the insurance would be paid in the following order: widow or widower, child or children, parents, or to the executor or administrator of the estate. If payment is not made in any of the methods indicated above, then it will be made to the next of kin under the laws of domicile of the member at the time of his death. Proceeds may, at the election of the serviceman or, in the absence of such an election, of the beneficiary, be paid either in a lump sum or in 36 equal monthly installments. Insurance will be continued without additional cost for a period of 120 days following discharge from the services.

Upon termination of the group coverage, the serviceman will have the privilege of converting to an individual insurance policy without medical examination in an amount not less than the amount of his group insurance.

The plan will be administered by a so-called prime insurer to be selected by the Veterans Administration. The Prudential Insurance Company has been elected to fulfill that function.

Other companies will have the privilege of participating in the program under a participation formula to be determined by the Veterans Administration. Also, other companies will have the privilege of offering conversion policies to the terminating servicemen even if they do not participate in the group insurance program as such. The participation formula for the group program and the rules governing eligibility as a company offering converted policies have not yet been announced.

The insurance industry welcomes the solution to the problem which has evolved within the framework of co-operation between government and private business. Undoubtedly, the outstandingly successful manner in which the program for civilian employees has been administered was a deciding factor in our favor. It also illustrates to us the need and advantages of aggressive action on the part of our industry when problems such as this one arise from time to time.

HENRY F. ROOD