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## REALIZED CAPITAL GAINS OF NON-QUALIFIED SEPARATE ACCOUNTS

by John C. Fraser

Realized capital gains of separate accounts funding variable annuities that are not tax qualified are subject to the 30% corporate capital gains tax if such gains are taxed as "long term" realized gains and are subject to substantially no tax if they are taxed as "short term" realized gains of the separate account, that is, if they are taxed on the same virtually tax free basis as the separate account's investment income. This peculiarity of the tax law has led some companies to consider "churning" their separate account portfolio every six months in order to generate short term rather than long term realized capital gains.

Before proceeding with such an investment policy, a company is advised to take a closer look at the situation; the mere "churning" of a separate account portfolio is not sufficient to achieve the desired tax free result. The capital gains tax is applied to the company as a whole, not to the separate account alone, and under current investment conditions where most companies have general account capital loss carryforwards and/or carrybacks to be used, this "churning" of the separate account will have no current tax effect, may very well have no future tax effect, may lead to bad investment timing because of forced selling and certainly to higher brokerage costs.

There are six capital gains tax situations that a company can be in (if we ignore the possibility of operations loss carryforwards and carrybacks, which would further complicate the problem).

1. If, in the current taxable year, there are both net short term gains and net long term gains, the former are taxed as investment income and the latter at 30%.

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## WORK AND THE QUALITY OF LIFE

*Work in America: Report of a Special Task Force to the Secretary of Health, Education, and Welfare. Foreword by Elliot L. Richardson, The MIT Press, Cambridge, Mass. 02142, pp. 252, \$2.95 (paper).*

by Arthur Pedoe

An alternative title could be "Work, Health and Longevity" for life without health is a tragedy and longevity without health a disaster. President Nixon in his 1971 Labor Day address said: "The most important part of the quality of life is the quality of work and the new need for job satisfaction is the key to the quality of work."

In the article in *The Actuary*, April 1972 the writer referred to the 15-year study of aging by Professor Edman Palmore of the Center for the Study of Aging and Human Development of Duke University. His researches indicated that *work satisfaction* was the best overall predictor of longevity and the second was *overall happiness*, reflecting a person's general satisfaction with his or her situation.

This interest in the quality of working life led the Hon. Elliot L. Richardson, then Secretary of Health, Education and Welfare, in December 1971 to appoint a special task force whose report, "Work in America," was recently published. Seven of the ten members of the task force held doctorates and were assisted by a team of seven research associates. Fifty special papers were commissioned and the bibliography indicates the literature reviewed by the task force covers over 600 items.

One's prejudices may be aroused by these sociological studies which often merely confirm, after infinite labor, conclusions which could be arrived at by common sense. However, "Work in America" is an exception; the report

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## SURVIVOR BENEFITS FOR THE UNIFORMED SERVICES

by Kriss Cloniger III

On Sept. 21, 1972, President Nixon signed Public Law 92-425 establishing a Survivor Benefit Plan (SBP) for the Uniformed Services. The SBP provides for survivor income of up to 55% of retired pay to the widows, widowers, and/or dependent children of retirees.

The most interesting features of this plan from an actuarial point of view are the premium formulas, the adjustment of premiums and benefits based on changes in the Consumer Price Index, the unique Social Security integration provisions, and a guaranteed annual income of \$2,100 for certain military widows.

Members of the Uniformed Services who retire on or after the date of signing will automatically be enrolled in the plan with maximum coverage if they have a spouse or dependent child on the date of retirement, unless they elect a lesser coverage or decline participation. Uniformed Service members already retired before the SBP's effective date are eligible to join the Plan voluntarily.

### Premiums and Benefits

A premium which will cover a portion of the cost of the Plan is withheld from retired pay. The applicable premium depends on the beneficiary class, of which there are four: (1) spouse only, (2) spouse and dependent child or children, (3) dependent child or children only, and (4) other person with an insurable interest in the retiree.

The premium formula for Class 1, spouse only, is 2½% of the first \$300 of monthly retired pay plus 10% of the remainder of that pay. This premium is payable during the retiree's lifetime.

For Class 2, the premium equals the Class 1 premium plus an additional

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## Survivor Benefits

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The additional amount, payable for as long as there is at least one child remaining as an eligible beneficiary, is to be sufficient to pay the cost of benefits to the children after the spouse is no longer eligible. The spouse's benefit eligibility ceases at death or at remarriage prior to age 60.

The Class 3 premium, payable only as long as at least one child remains an eligible beneficiary, is to be sufficient to pay the cost of the benefits to the children after the death of the retiree.

The Class 4 insurable interest premium is somewhat higher. It is 10% of the retiree's full retired pay plus an additional 5% for each full five years the beneficiary is younger than the retiree, subject to a maximum cost of 40% of retired pay.

Beneficiaries in Classes 1 through 3 will receive the maximum of 55% of retired pay unless the member elects to have premiums and benefits based on a lesser amount down to \$300 per month. Class 4 beneficiaries receive 55% of retired pay net of the SBP premium. Both premiums and benefits are adjusted for changes in the Consumer Price Index.

## Consumer Price Index

The CPI adjustment occurs whenever the CPI increases by 3% since the last adjustment date and does not dip below that level for three consecutive months. The amount of the adjustment is equal to the percentage increase in the CPI between the month of the last adjustment and the current adjustment month plus 1%. The extra 1% is meant to recognize the lag time in the adjustment process.

## Social Security Integration

Perhaps the most interesting feature of the plan is the provision relating to Social Security integration. Two types of Social Security benefits are fully offset against SBP benefits, while other social security benefits are ignored for offset purposes. If a widow has exactly one dependent child, the SBP payment is reduced by an amount equal to the Social Security mother's benefit to which the widow would be entitled based solely upon uniformed service of the retiree and related assuming he lived to age 65. When the widow or widower reaches age 62 or there is no longer a dependent child, whichever occurs later, the amount of the SBP payment will be reduced by

the amount of the Social Security survivor's benefit calculated under the above-mentioned assumptions. When there are two or more children, the mother's Social Security benefits are ignored because integration would produce a lower SBP benefit than is available to similar beneficiary classes under the civil service survivorship plan.

During the Congressional hearings on this legislation, the Department of Defense recommended that one-half of the amount of Social Security attributable to military service be offset against the SBP payment. Congress rejected this recommendation primarily in order to achieve comparability between the civil service and the military survivor's benefit plans. The civil service retiree's contributions, which are made during active service and retirement, provide 60%—62.5% of the cost of the civil service survivorship plan.

With the full offset for Social Security in the two cases described above, the military member who currently enters military service will contribute, on the average, about 62.7% of the total cost of the survivor benefits (including Social Security). The member's contribution includes the SBP premium and one-half of the value of the Social Security benefit, on the assumption that his Social Security contribution pays for one-half of the Social Security benefit. With the one-half offset, the member would contribute about 55%. The deficiency of 37.3% of the total cost of military survivor benefits will be financed from general revenues and will be included in the defense budget.

## Guaranteed Annual Income

One additional purpose of the SBP bill is to provide a guaranteed minimum annual income of \$2,100 per year to current widows of retired military personnel. Many widows are not covered by either Social Security or by the SBP's predecessor, the Retired Serviceman's Family Protection Plan (RSFPP). Only about 15% of military retirees participated in the voluntary RSFPP. Consequently, a large number of widows have no survivorship rights in their husband's retirement income. The guaranteed annual income is to help provide for those who have no other significant sources of income. The Survivorship Benefit Plan was passed to avoid this problem in the future. □

## Death

Robert P. White

## Tontine

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aries and commissions were abuses that could be laid directly at the door of the deferred dividend system. High lapse rates and disappointed policyholders (who saw the actual dividends paid fall short of the estimated dividends) generated angry letters and, in some cases, law suits. But, not until the Armstrong Committee made its report and the New York Legislature acted on it, was anything done to curtail the abuses of the system. Once action was taken, however, it was immediately effective in causing the Tontine-type policy virtually to vanish from the life insurance scene.

The interesting point of Mr. Cooper's monograph is that the story does not stop with a demise of Tontine insurance schemes in 1906. His final chapter briefly touches on six forms of modern Tontine schemes. Earlier, he had defined the Tontine principle as a scheme ". . . whereby those members of a specified group who survive and/or persist receive a future benefit of an unknown amount at the expense of those members who die and/or withdraw from the group." The manner in which Congress and the news media are criticizing pension plans would suggest that at least one form of modern Tontine is not only with us still but is, perhaps, causing the same old types of problems insofar as the participants are concerned. In an area such as this, it is perhaps too bad that the deliberate brevity of the monograph precludes a full or clear analysis of the problem and its ramifications.

Nevertheless, not since Thomas Costain wrote "*The Tontine*" has there been anything as readable, in my opinion, on the subject. On the other hand, this is no historical novel so that the background of information is much more complete, albeit impersonal. The large number of footnotes is an invitation for further reading and, perhaps, that is in itself a sufficient recommendation for this monograph.

This is the first of a series of monographs to be published by the S. S. Huebner Foundation and it is a good augury for subsequent volumes. The monograph is distributed by Richard D. Irwin, Inc., Homewood, Illinois. □