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THE SOCIETY'S LIBRARY

Members may not be aware that the Society of Actuaries has had, since its inception, a library; and that since February 1986 the library has had a professional librarian. This article is intended to make us all more aware of the library facilities we already have, and the plans for the future.

The librarian is Joan Chapa, hired early this year on a part-time basis, but to become full-time in 1987. Joan took her training in Library Science at Illinois State University and the University of Illinois, earning a Master's degree from the latter in 1981. She has also been a practicing librarian in the public library of Mount Prospect, Il.

The Society library was inherited from its predecessor organizations, the Actuarial Society of America and the American Institute of Actuaries, when these two organizations merged to form the Society of Actuaries in 1949. The very beginnings of the library were from a bequest to the old Society from the estate of William D. Whiting, who died in 1899. The library later grew, largely through the contributions of members. A notable gift of actuarial books came in 1936 from C.D. Higham of London.

With the formation of the Society of Actuaries the library moved to Chicago, to be administered by the Society secretary; but in 1964 the library moved back to New York. There it was housed and administered by the Insurance Society of New York and the College of Insurance. The collection came back to Chicago in 1980, and moved again when the Society office moved to Itasca. It is only since the appointment of a professional librarian, however, that the library is beginning to receive the attention it deserves.

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ELECTIONS 1986

The results announced at the Annual Meeting in Chicago are:

President-Elect
Gary Corbett
Vice-Presidents
Allan D. Affleck
Robert C. Dowsett
John O. Montgomery
Secretary
Richard V. Minck
Treasurer
Michael J. Cowell
Director of Publications
Anthony T. Spano
Board of Governors
A. Norman Crowder, III
Phyllis A. Doran
Curtis E. Huntington
Richard K. Kischuk
James J. Murphy
Michael R. Winn

2,743 valid ballots were cast, 48.9% of the eligible voters. The 1985 percentage was identical. Only 14 invalid ballots were received. □

1987 AERF GRANTS COMPETITION

The Actuarial Education and Research Fund (AERF) is sponsoring a 1987 grants competition. One or more grants, ranging from $5,000 to $10,000, will be available through AERF and its constituent organizations to support actuarial education or research projects. Funds may be used to compensate grant recipients or to cover expenses for services utilized in carrying out the project.

The goal of the competition is the production of publications which will advance actuarial science especially in regard to practical applications. For this purpose, proposals are invited from members of the actuarial organizations

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TAXATION OF INSURANCE COMPANIES — ACT OF 1986

By John H. Elken

The Tax Reform Act of 1986 has now become law, though its various effective dates are still in the future. The Act involves sweeping changes, generally lowering tax rates and broadening the taxable income base. While in total the rate reductions are offset by base broadening, individuals as a whole will pay less and corporations more.

The Act makes important changes in the taxation of insurance products and the rules governing employee benefit plans, both of interest to actuaries; but these are outside of the scope of this article. Here we concentrate on the corporate income tax, and how the Act affects the taxation of insurance companies.

In General

The top corporate tax rate is reduced from 46% to 34%, effective July 1, 1987. Calendar year taxpayers will pay the blended rate (40%) for 1987. Lower rates apply to corporate incomes under $75,000, but these savings are recaptured by a 5% surtax on income between $100,000 and $335,000. The effect is that all corporations with incomes in excess of $335,000 pay tax at the 34% rate after Jan. 1, 1988, subject of course to all other provisions of the new law.

Corporate capital gains rates move from 28% to 34% for gains realized in tax years beginning after Dec. 31, 1986. While the rate of tax soon becomes the same as for ordinary income, the separate identity of capital gains (and losses) will be retained, to allow for limits on deductibility of losses and to

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Taxation of Insurance Companies

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preserve the 34% rate if the ordinary rate increases (a troublesome reason).

The Alternative Minimum Tax (AMT) has been strengthened. The concept of AMT is that of a minimum tax, calculated as 20% of regular taxable income plus preference income. Preference income includes accelerated depreciation, tax-exempt interest on most nongovernmental-purpose bonds issued since Aug. 7, 1986, and one-half of untaxed but reported profits (book income). Some corporations have been paying little tax, but at the same time reporting significant earnings to their stockholders. Now income reported on financial statements will affect the AMT.

The corporate dividends received deduction is reduced from 85% to 80%. Hence the effective tax rate on such dividends drops from 46% of 15% = 6.9% to 34% of 20% = 6.8% (except for 1987).

Effect on Life Companies

The 20% taxable income adjustment in present life insurance tax law is repealed Jan. 1, 1987. The effective tax rate for life insurers in 1986 is 80% of 46% or 36.8%, increasing to 100% of 40% for 1987, then falling to 34% in 1988 and later. While technically the increase for 1987 — unique under this bill — comes about through base broadening, most analysts will treat it as a rate adjustment.

For the calculation of "book income", a part of the AMT computation, income reported on financial statements will be the base for the first three years of the new law. If the corporation issues audited GAAP financials, these will be used; if not, financials reported to regulatory bodies will be substituted. The effect is that most stock insurance companies will use GAAP earnings for AMT purposes, while mutuals will use statutory. Attempts by the industry to standardize on statutory have been so far unsuccessful.

After the first three years the "business untaxed reported profits" shifts to "earnings and profits", a concept from current tax law designed to determine whether a distribution to shareholders is from capital or from earnings. This is not precisely defined, and there are few court cases to make the meaning clear. Tax writing staff was attempting to draft language to improve this situation when this article was being written.

In a late technical amendment, Congress confirmed the grandfathering of pre-1983 modified co-insurance contracts except in case of fraud. The IRS had been challenging certain aspects of these arrangements on audit.

Effect on Property-Casualty Insurance Companies

Property and casualty insurers experience both the rate reduction and the base broadening. The rates go from 46% in 1986 to 40% in 1987, to 34% in 1988 and thereafter. Other changes affecting these insurers have the effect of lowering reserve deductions.

Eighty percent, rather than 100%, of changes in the unearned premium reserves is allowable as a deduction. Twenty percent of the 1986 reserve is to be brought into income over six years.

The deduction for loss reserves will be reduced by 15% of tax exempt interest and the deductible portion of corporate dividends received.

It has been standard P&C practice to ignore the time value of money in setting up loss reserves. The Act provides for discounting as of the beginning of 1987. The decrease from the end-of-1986 reserve will not be taken into taxable income (there will be a "fresh start"); but it will add to 1987 "earnings and profits".

The Act repeals the deductions for additions to the protection against loss account (PAL) for mutual P&C companies. The PAL account balances as of the 1986 year-end will be included in income in the same manner as under the former law.

The Act continues to allow full deduction of policyholder dividends for both stock and mutual P&C insurers; but it provides for a Treasury study, including the appropriateness of an ownership differential similar to that already existing for mutual life insurance companies.

A Competitive Change

A change not directly affecting insurance companies, but of interest to those who compete against Blue Cross and Blue Shield, is that these organizations will be taxed as if they were stock P&C companies. There are special allowances, set to reach a revenue target, that will be detailed in the final draft.

Industry Success?

Some observers feel that the insurance industry did rather well. There is ample room for difference of opinion.

If one compares the final result with Treasury proposals, it is clear that the industry was quite successful. An important base broadening proposal which did *not* survive was to use guaranteed cash values in determining the reserve deduction. The 1986 Act continues the federally mandated method of computing tax reserves introduced by the 1984 Act.

In any case, the impact of the new law on the corporate tax of insurance companies is not nearly as negative as it appears to be in some other industries. Some insurance companies may pay more tax, others less — but the overall tax paid by the entire industry may not be much different. □

THE ROLE OF INTEREST IN FINANCING THE OASDI SYSTEM

By Robert J. Myers

Let us assume that the OASDI system is funded in the future so that it is on a current cost basis — which is not the case under current law. Further, assume that the goal is to maintain the trust-fund balance at the level of one year's outgo on a retrospective basis (i.e., measuring the fund balance at the end of the year against outgo for the year). The question then is what effect do the interest earnings of the OASDI Trust Funds have on the overall financing of the system?

This will be considered on the basis of the intermediate (Alternative II-B) estimates contained in the 1986 Trustees Report, as extended by Actuarial Note No. 127, Social Security Administration. Under this estimate, the fund balance at the end of 1993 ($396.7 billion) is almost exactly equal to the outgo for 1993. If this fund balance is accumulated at the ultimate interest rate used in the actuarial estimates (6.08% compounded annually) until the end of 2055, the result is $15.4 trillion, which is

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