TRANSACTIONS OF SOCIETY OF ACTUARIES
1960 VOL. 12 NO. 33

FEDERAL INCOME TAX

What effect will the federal income tax have on the guarantees involved in

1. Immediate and deferred annuity considerations
2. Settlement options
3. Pension funds
4. Interest on funds left on deposit
5. Nonparticipating premiums?

MR. HARRY WALKER pointed out that companies writing participating annuity contracts might be encouraged to adopt higher guaranteed interest rates in conjunction with a given mortality and loading basis. This would have the effect of reducing the total funds (reserves plus surplus) held by the company and lowering the total tax paid. He noted that the combination of higher interest with a modern mortality table would be more advantageous than an out-dated table with an interest rate producing the same level of reserves. Though the same considerations do not hold for individual annuities issued to pension trusts, similar rate structures would probably be used for consistency.

Mr. Walker also expected the trend toward more modern mortality and less conservative interest assumptions to be evident in settlement option rates during the contingent period (and, for some companies, during the certain period). Though the law won't necessarily affect guaranteed rates on settlements without life contingencies, practical considerations will probably limit the difference in guaranteed rates between settlements involving life contingencies and those without. There will probably be an increase in excess interest dividends on funds not involving life contingencies, since any interest withheld is subject to the 52% tax.

Mr. Walker felt that companies writing participating individual pension trust policies might find it wiser to reflect any credit on "pension plan reserves" through dividends rather than gross premiums, because of the possibility of future changes in the law.

MR. JOSEPH C. NOBACK also commented on the effects of higher interest assumptions and observed that more conservative mortality assumptions may be required. With respect to funds held at interest, he noted that tax credit is received for the total rate paid whether guaranteed or not. His company would prefer to keep guarantees modest and recognize relatively more excess interest through dividends. He asked whether any companies were considering crediting the rate actually earned to funds left on deposit, with specific charges for the expense of option services. MR. FRANK D. LOGAN replied that to his knowledge this approach was not being considered by any other companies.

MR. PETER W. PLUMLEY reported the results of asset shares calculations designed to reveal the relative effect of the new tax law on various nonparticipating policy forms. His conclusions were that greater after-tax profits would be realized on the higher premium forms and less on the lower premium forms. Also, due to the effect of Phase 2 on profits, the "no profit" premium for virtually all forms was lower than before. Because of the sharp increase in over-all tax, however, it could not be concluded that lower premiums on many policy forms should result.

Three sources of meeting the increased tax were through reduced dividends to stockholders, reduced surplus accumulation or increased premiums, with the last alternative probably being the most desirable and reliable from the company's point of view. Mr. Plumley then outlined two methods which might be used to provide for the tax in calculating gross premiums. The first method would assign additional amounts of surplus to the various asset share calculations, with the tax computed accordingly. Under the second approach, each policy form would be required to develop larger profits after tax than under previous calculations to make up for the increased tax on surplus funds. Regardless of the approach followed, however, it is important for the company to attract new money at the present time, and this consideration might result in reduced premiums for the higher premium forms.

MR. DICKINSON C. DUFFIELD pointed out that his company was using a projection scale in its group annuity rates. He felt that, for a given level of premiums, an improving mortality table would hold relatively more funds as reserves and less as surplus over future years than a static table. Therefore, the aggregate income tax should be lowered.