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

DIGEST OF SMALLER COMPANY FORUM

FEDERAL INCOME TAX

A. What problems have been encountered by companies in the preparation of their federal income tax return?
B. What formulas or rules of thumb have been devised to facilitate computing or estimating taxes?
C. Are the special small company provisions of the tax law accomplishing their objectives?

MR. WALTER S. DEWAR, discussing sections A and B, gave the position Great Southern Life adopted in handling these items:

Deferred and Uncollected Premiums

His company excluded them from Total Assets on the grounds that they are assets used in carrying on an insurance trade or business for these two reasons:

(1) The Senate Finance Committee said that "property used in carrying on an insurance business" does not include the so-called invested assets from which interest, rents, dividends, and royalties are derived. Since assets used in the insurance business do not earn income, it would seem that "assets" which do not earn income are assets used in the insurance business.
(2) Deductible investment expenses are limited by formula and are based on mean assets as defined in Section 805 (b). Deferred and Uncollected premiums are an inventory item controllable by policyholders, and it would be unrealistic to include them in the calculation. However, they were used in determining premium income for Phase 2.

Premium Deposit Funds

In Phase 2, only the net increase in the P.D.F. was considered as income.

Bond Premium Amortization

The law requires amortization to call or maturity date, whichever produces the lower amortization deduction, on bonds acquired after December 31, 1957, if interest is fully taxable. As a result, separate records for tax and statement purposes are frequently required. The following rules were developed for use by their Investment Department:

Rule 1. That bonds purchased at a premium or discount which are not callable before maturity be amortized in the manner used for Annual Statement purposes.
Rule 2. That bonds purchased at a premium which have an optional call date prior to maturity be amortized to either the call date or the maturity date, according to whichever would result in the lower annual amortization charge.
Rule 3. That for a bond which, under Rule 2, is amortized to the optional call

date, but which is not called on that date, the remaining premium (the difference between the call price and the maturity value) will be amortized over the period remaining to maturity.

Rule 4. That for a bond which, under Rule 2, is amortizable to maturity date, but is called on the optional date, the remaining unamortized premium will be entered as amortization in the year so called.

Interest on Supplementary Contracts Not Involving Life Contingencies

Phase 2 interest is found by applying the appropriate interest rate to the mean of the reserves. In Phase 1, the Great Southern used the interest emerging from the Analysis of Increase in Reserves formula.

Deferred Annuities

Interest-only deferred annuities were counted as life insurance reserves as they were so treated under the old law.

Depreciation

Depreciation was allocated to the investment department, using as a guide gross investment income (adjusted for rental value of home office building) and gross premium income.

MR. RICHARD M. FRIDLEY discussed the special problem of income taxes paid to foreign companies encountered by Pan-American Life in its operations in 12 foreign countries. The new law allows as a deduction only the smaller of the actual tax paid to the foreign country *or* the amount of tax, calculated under the U.S. law, originating from that country's operations.

Since the operations in any particular foreign country will not contribute to Phase 1 and 2 in direct proportion to the over-all Phase 1 and 2 calculations, an allocation is required which depends on the relation between Phase 1 and 2 for the over-all return as well as for the specific foreign country.

If the Company is taxed on Phase 2 in U.S. and, in effect, on Phase 1 in a particular foreign country, then the effect is to increase the tax burden.

The Pan-American concluded that it would be necessary to develop reserves by country in order to properly prepare their tax return.

On section C, he said that many small companies have no Phase 1 tax because reserves adjusted to the net level basis, coupled with an earned rate less than the assumed rate, produced reserves greater than assets, so that all investment income was allocated to policyholders.

In Phase 2, the small company deduction, the net level reserve adjustment, and the nonparticipating deduction were mentioned as giving definite tax relief.