[JOINT COMMITTEE PRINT]

VERVIEW OF FEDERAL TAX TREATMENT OF LIFE INSURANCE COMPANIES AND 1988 NTERIM TREASURY DEPARTMENT REPORT

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON
SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

ON SEPTEMBER 27, 1988

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

[he Subcommittee on Select Revenue Measures of the House nmittee on Ways and Means has scheduled a public hearing on ptember 27, 1988, on certain aspects of life insurance company :ation.

[he Subcommittee hearing will review the provisions governing taxation of life insurance companies which were substantially 'ised in the Deficit Reduction Act of 1984 ("1984 Act"). The hear- will focus on preliminary data on the amount of Federal ome taxes paid by the life insurance industry (mutual life insur- ce companies and stock life insurance companies) since enact- nt of the 1984 Act. The Subcommittee will consider the June 38 *Interim Report to the Congress on Life Insurance Company xation*, prepared by the Treasury Department, which was man- ed in the 1984 Act.

'his pamphlet,[1] prepared by the staff of the Joint Committee on xation in connection with the Subcommittee hearing, provides overview of the Federal tax treatment of life insurance compa- s and the 1988 interim Treasury Department report.

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[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Overview of Federal Treatment of Life Insurance Companies and 1988 Interim Treasury Department Report* (JCS- 8), September 23, 1988.

I. SUMMARY

Present Law

The Deficit Reduction Act of 1984 ("1984 Act") contained p
sions limiting the deduction for policyholder dividends paic
mutual life insurance companies. The Congress determined th
reason for these provisions was that, because a mutual compa
policyholders are also owners of the company, a portion of the
icyholder dividends paid to them represent a return of comp
profits (i.e., a return of capital). In addition, these provisions v
designed to ensure that mutual life insurance companies would
55 percent of the total Federal income tax collected from the
insurance industry. For mutual life insurance companies,
amount of the deduction for policyholder dividends is reduced
the "differential earnings amount." This amount is computed
multiplying the company's average equity base for the taxable
by the "differential earnings rate" for the taxable year. The di
ential earnings rate is the excess of the "imputed earnings ra
over the "average mutual earnings rate". As explained below,
"imputed earnings rate" is designed to provide comparable tr
ment for stock and mutual companies.

The imputed earnings rate for 1984 was 16.5 percent. For tax
years beginning after 1984, the imputed earnings rate is an amo
which bears the same ratio to 16.5 percent as the current st
earnings rate (i.e., the numerical average of the rates of return
the 50 largest stock companies for the preceding 3 taxable ye
bears to the base period stock earnings rate (i.e., the numerical
erage of the rates of return for the 50 largest stock companies
1981, 1982, and 1983). The average mutual earnings rate for
year is the weighted average of the rates of return for all mut
companies.

Life Insurance Industry Studies Mandated by the 1984 Act

Two issues that were of concern during the process of reformu
tion of the tax treatment of life insurance companies in 1984 w
(1) the amount of Federal income tax paid by the life insurance
dustry, and (2) the relative Federal income tax burden borne
mutual and stock life insurance companies. The Congress de
mined that these issues should be closely scrutinized and thus,
1984 Act instructed the Treasury Department to prepare reports
these two issues. The first interim report to the Congress was p
vided by the Treasury Department on June 15, 1988.[2]

[2] Department of the Treasury, *Interim Report to the Congress on Life Insurance Company* ation, June 1988 ("1988 Treasury Report").

erim Treasury Department Report

'he 1988 Treasury Report concludes that the Federal income tax 'ments of the life insurance industry and the relative share of paid by the mutual and stock segments in 1984 and 1985 did meet estimates made at the time of the 1984 Act.

everal factors should be considered in interpreting the Treasury port data. First, the data are preliminary and have not been y verified by the Treasury Department. Second, the data do not ect amendments and audit adjustments to 1984 and 1985 tax re- ns made after the date of the 1987 Treasury Survey. Third, the enue estimates are shown on a consolidated return basis. rth, the data do not include taxes paid by stockholders of life ırance companies (policyholders in the case of mutual life com- ies) with respect to such stock. Last, tax minimizing behavior in life insurance sector, such as an increase in tax exempt bond ıership, may increase tax liability in other sectors (as a result of ıced ownership of tax exempt bonds in these sectors). Thus, a tion of the revenue change attributable to the insurance provi- ıs of the 1984 Act could be reflected on the tax returns of tax- ers other than insurance companies.

summary of the 1988 interim Treasury Report is in Part III.

II. PRESENT-LAW RULES RELATING TO THE TAX TREATMENT OF LIFE INSURANCE COMPANIES

A. 1984 Act Changes

The Deficit Reduction Act of 1984 ("1984 Act") restructure
Federal income tax treatment of life insurance companies b
placing a three-phase tax structure with a single-phase struc
The single-phase tax structure was based on a stock life insur
company model in order to provide a relatively simple tax s
ture for life insurance companies that bore a close resemblan
the general tax treatment of corporations. In addition, the choi
the stock company model reflected the view that life insur
companies should be subject to tax at corporate rates.

The 1984 Act also contained provisions limiting the deductio
policyholder dividends paid by mutual life insurance compa
One reason for these provisions was that, because a mutual co
ny's policyholders are also owners of the company, a portion o
policyholder dividends paid to them was considered to represe
return of company profits (i.e., a return of capital). In addi
these provisions were designed to ensure that mutual life insur
companies would pay 55 percent of the total Federal income
collected from the life insurance industry in 1984.

B. Definition of a Life Insurance Company

Under present law, a life insurance company is defined as a
surance company that is engaged in the business of issuing lif
surance contracts, annuity contracts, or noncancellable acci
and health insurance contracts if more than 50 percent of the t
reserves of the company are life insurance reserves or unear
premiums and unpaid losses on noncancellable life, accident
health contracts that are not included in life insurance reser
For purposes of this definition, an insurance company is any c
pany for which more than half of the business activity of the c
pany during the year is the issuing of insurance or annuity
tracts or the reinsuring of risks underwritten by insurance co
nies.

Whether more than half of the business activity of a compan
the issuing of insurance or annuity contracts depends on the f
and circumstances. Factors to be considered include the numbe
employees assigned to, the amount of space allocated to, and
net income derived from, the various business activities. The c
acter of the business actually carried on in the taxable year de
mines whether a company is taxed as an insurance company.[3]

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[3] *See, e.g., Service Life Insurance Co.* v. *United States*, 189 F. Supp. 288, *aff'd. on*
grounds, 293 F.2d 78 (9th Cir. 1961).

C. Computation of Life Insurance Company Taxable Income

fe insurance company taxable income

A life insurance company is taxed at corporate rates on its life surance company taxable income (LICTI). LICTI is life insurance oss income reduced by life insurance deductions. A stock life in-rance company is also taxed, at corporate rates, on any distribu-ns from a pre-1984 policyholders' surplus account.

Life insurance gross income is the sum of (1) premiums, (2) de-eases in certain reserves, and (3) other amounts generally includ-e by a taxpayer in gross income. For these purposes, premiums nsist of the gross amount of premiums and other consideration ceived on insurance and annuity contracts reduced by return pre-ums paid to policyholders, such as on the cancellation of a licy, and premiums and other consideration paid to another in-rer on indemnity reinsurance.

The premiums and other consideration taken into account in-ide advance premiums, deposits, fees, assessments, consideration respect of assuming liabilities under contracts not issued by the xpayer, and any policyholder dividends reimbursable by a rein-rer. Return premiums do not include amounts paid to policyhold-s that are not fixed in the contract but depend on the experience the company or the discretion of the management, except in the se of return premiums or other consideration returned to an-ier life insurance company under an indemnity reinsurance con-ict. Amounts rebated or returned due to policy cancellations or erroneously computed premiums are to be treated as return pre-ums.

neral deductions

Life insurance companies are allowed deductions for (1) claims d benefits accrued, and losses incurred (whether or not ascer-ned) during the taxable year on insurance and annuity con-icts, (2) net increases in reserves, (3) policyholder dividends, (4) idends received by the company (limited to the company's are), (5) operations losses, (6) consideration paid for assumption nsurance, and (7) policyholder dividend reimbursements paid to other insurance company under a reinsurance agreement. In ad-ion, life insurance companies are allowed other deductions gen-illy allowable to corporate taxpayers for purposes of computing able income, subject to certain modifications.

all life insurance company deduction

Small life insurance companies are allowed an additional special luction that is not available to other taxpayers. The amount of deduction is 60 percent of so much of tentative LICTI for such able year as does not exceed $3 million, reduced by 15 percent the excess of tentative LICTI over $3 million. The small life in-rance company deduction is only allowable to companies with ss assets of less than $500 million.

ductions with respect to reserves

n general, life insurance companies are allowed a deduction for iet increase in reserves and must take into income any net decrease in reserves. In general, the net increase or net decrease reserves is computed by comparing the closing balance of the serves to the opening balance of the reserves, with the closing b ance of the reserves becoming the opening balance for the follo ing year.

In computing the net increase or net decrease in reserves, t closing balance of the reserve items is reduced by the policyholde share of tax-exempt interest. A life insurance company's reserve ability to its policyholders in effect entitles the policyholders to pro rata portion of each item of investment income, including ta exempt income.

In computing the net increase or net decrease in reserves, t following six items are taken into account: (1) life insurance serves; (2) unearned premiums and unpaid losses included in to reserves; (3) amounts that are discounted at interest to satisfy ob gations under insurance and annuity contracts which do not volve life, accident, or health contingencies when the computati is made; (4) dividend accumulations and other amounts held at terest in connection with insurance and annuity contracts; (5) p miums received in advance and liabilities for premium depo funds; and (6) reasonable special contingency reserves under co tracts of group-term life insurance or group accident and health surance that are held for retired lives, premium stabilization, or combination of both.

For purposes of determining life insurance company taxab income, the life insurance reserve for any contract is the greater the net surrender value of the contract or the reserve determin under Federally prescribed rules. In no event may the amount the tax reserves at any time exceed the amount of the statuto reserves, which include any deficiency reserves relating to the abilities. The net surrender value is the cash surrender value duced by any surrender penalty, except that any market value a justment required on surrender is not taken into account.

In computing the Federally prescribed reserve for any contra the tax reserve method applicable to that contract must be use along with the prescribed interest rate and the prevailing comm sioners' standard tables for mortality or morbidity. Thus, in co puting the Federally prescribed reserve, a company begins with statutory or annual statement reserve, and modifies that reserve take into account the prescribed method, the prescribed intere rate, the prevailing mortality or morbidity table, as well as t elimination of any net deferred and uncollected premiums and t elimination of any reserve in respect of "excess interest" guara teed beyond the end of the taxable year. Except for the Federal prescribed items, the methods and assumptions employed in co puting the Federally prescribed reserve are to be consistent wi those employed in computing a company's statutory reserve. Ho ever, to avoid State-by-State variations, the prescribed rules a based on the general guidelines recommended by the National A sociation of Insurance Commissioners (NAIC) and adopted by a m jority of the States.

In general, the Federally prescribed reserve methods refer those recommended by the NAIC for a particular type of contra There is no requirement that the method also be required based o

: prevailing view of the States. Thus, as a general rule, in com- :ing any life insurance reserve, a company is required to take o account any factors specifically recommended by the NAIC. If :cific factors are not recommended by the NAIC prescribed re- ve method, the prevailing State interpretation of such method is isidered for purposes of determining what factors are to be taken o account in applying the computation method for tax purposes.

erest rates

'he interest rate to be applied in determining the amount of the insurance reserves for any contract is the greater of the appli- le Federal interest rate or the prevailing State assumed interest e for the calendar year in which the contract is issued. The ap- :able Federal interest rate is the rate determined under the dis- nting rules for property and casualty reserves for the calendar r in which the contract is issued. The "prevailing State assumed erest rate" means, for any contract, the highest assumed inter- rate permitted to be used in at least 26 States in computing life irance reserves for insurance or annuity contracts of that type of the beginning of the calendar year in which the contract is ied.

1 the case of reserves for contracts that do not involve life, acci- t, or health contingencies, the interest rate to be applied is the atest of (1) the applicable Federal interest rate, (2) the prevail- State assumed interest rate, or (3) the rate assumed by the pany in determining the guaranteed benefit.

nder present law, life insurance companies are allowed a one- e election (revocable only with the consent of the Secretary of Treasury) to apply an updated applicable Federal interest rate ry 5 years in calculating life insurance reserves. The election is vided to take account of the fluctuations in market rates of irn that companies experience with respect to life insurance :racts of long duration.

nder the election, the rate in effect in the year in which a con- t is issued continues to be applied in the 4 succeeding years r the year the contract is issued. For the 5th through 9th year r the contract is issued, the rate to be applied in determining rves for such years (but not for any prior years) with respect to contract is the greater of the applicable Federal interest rate such 5th year or the prevailing State assumed interest rate for calendar year in which the contract was issued. Thus, the rate determining life insurance reserves with respect to any contract not be lower than the prevailing State assumed interest rate for calendar year in which the contract was issued.

ie use of the updated applicable Federal interest rate under the tion does not cause the recalculation of life insurance reserves any prior year. Thus, for example, if an updated rate is applied alculate life insurance reserves in the 10th year following the in which the contract was issued, the amount of the compa- life insurance reserves, and its deduction for additions to re- es, for the preceding 10 years are not affected.

ction 807(f), which generally provides a 10-year spread for any ige in computing reserves, does not apply to the use of an up- d applicable Federal interest rate under the election. Instead, the difference between the opening reserve computed under the interest rate and the opening reserve computed under the new terest rate is to be taken into account entirely for the yea which the new interest rate applies.

Under the election, no change is made to the interest rate u in determining life insurance reserves if the updated applica Federal interest rate is less than one-half of one percentage p different from the rate utilized by the company in calculating insurance reserves during the preceding 5 years. Thus, for ex ple, if the applicable Federal interest rate is 7.5 percent, and rate utilized by an electing company during the preceding 5 ye is 7.6 percent, the company continues to use the 7.6 percent r during the second 5-year period with respect to reserves for t contract year. This rule parallels the calculation of State assur rates under the Standard Valuation Law, under which a chang less than one-half of one percentage point does not give rise t change in the State assumed rate.

The election applies to all contracts issued during the calen year for which the election is made and any subsequent calen year unless the election is revoked with the consent of the Se tary of the Treasury.

Mortality tables

The prevailing commissioners' standard tables for mortality morbidity to be used for computing the Federally prescribed serves are, with respect to any contract, the most recent tables p scribed by the NAIC and permitted to be used for that type of c tract in computing reserves under the laws of at least 26 Sta when the contract is issued. If a table becomes a prevailing co missioners' standard table during a calendar year, then the n table may be used as the prevailing table from the beginning of calendar year. Generally, when mortality and morbidity tables being updated and adopted by the States, companies will hav full years after a particular set of tables becomes the prevail view of the States before such table becomes mandatory for co puting reserves for tax purposes.

Deductions for policyholder dividends

Present law allows a deduction for dividends or similar distri tions to policyholders. The amount of the deduction for any taxa year is the amount of policyholder dividends paid or accru during the taxable year.

In general, policyholder dividends are dividends and similar d tributions to policyholders, but not return premiums. The te "policyholder dividends" generally refers to amounts returned policyholders that are not fixed in the contract, but depend on t experience of the company or the discretion of management.

The term policyholder dividends includes any distribution to policyholder that is the economic equivalent of a dividend. Thus, addition to any amount paid or credited to policyholders (includi an increase in benefits) that is not fixed in the contract but d pends on the experience of the company or the discretion of ma agement, the term policyholder dividends specifically includ

:ess interest, premium adjustments, and experience-rated re-
ıds.

'he term "excess interest" means any amount in the nature of erest that is paid or credited to a policyholder and determined a rate in excess of the prevailing State assumed interest rate for contract. Amounts in the nature of interest include all ounts paid for the use of money regardless of the particular des- ation adopted by the payor or payee. Thus, amounts in the ure of interest include interest payments with respect to ounts left on deposit and amounts paid in lieu of interest, such in the case of origination or service fees. Similarly, amounts in nature of interest include amounts calculated as interest (e.g., increase in reserves or cash surrender values attributable to as- ned or guaranteed interest rates rather than premium contribu- ns). Thus, for example, any increase in the cash surrender value contract above that which would result if the prevailing State umed interest rate were used to compute the increase is treated excess interest.

'he term "premium adjustment" means any reduction in the mium under an insurance or annuity contract which, but for h reduction, would have been required to be paid under the con- t. If no premium amount is fixed in the contract, variations in miums paid during the course of the contract are not considered mium adjustments. Further, a change in the amount of a premi- that is attributable to the insurability of the insured is not con- red a premium adjustment.

inally, the term "experience-rated refund" means any refund or lit based on the experience of the contract or group involved. ıs, for example, if a company sells a group policy to an employer ering the lives of its employees and the premiums received eed the sum of the claims paid and other expenses, any refund uch excess is an experience-rated refund. Any policyholder divi- d that increases any of the benefits payable under the contract luding the cash surrender value), or reduces the premium oth- ise required, is treated as paid to the policyholder and returned he policyholder to the company as a premium.

D. Deductions of Mutual Life Insurance Companies

eneral

lthough the general rules and definitions relating to policyhold- lividends apply to stock and mutual life insurance companies e, for mutual companies, the amount of the deduction for pol- older dividends is reduced by the "differential earnings unt." If the differential earnings amount exceeds the allowable uction, then the excess reduces the closing balance of the com- y's reserves. This reduction reflects the Congress' determina- in 1984 that, to some extent, policyholder dividends paid by ual companies are distributions of the companies' earnings to cyholders as owners.

ecause a mutual company's policyholders are also the owners of enterprise, policyholder dividends paid to them are distribu- s from the company that are a combination of price rebates, cyholder benefits, and returns of company profits. Although there is no precise way to segregate a policyholder dividend other payment into these various components, the Congress cluded that profit-oriented enterprises tend to distribute earni to their owners in amounts that are proportional to the own equity in the business. Thus, the Congress determined that the tion of a policyholder dividend that is a distribution of earni can be measured as a percentage of the mutual company's eq (the "average equity base"). To determine the appropriate perc age of the equity base, the post-dividend rates of return on eq for both stock and mutual companies were examined. The aver post-dividend, pre-tax return on equity of mutual companies less than the average post-dividend, pre-tax return on equity fo comparable group of stock companies at and prior to the time reduction in mutual company deductions was enacted. The C gress concluded that this difference was attributable to distribut by mutual companies of earnings to their owners.

This approach to identifying ownership distributions by a mut company is given effect by means of a reduction in the policyhol dividends deduction by a "differential earnings amount." T amount is computed by multiplying the company's average equ base for the taxable year by the "differential earnings rate" for taxable year. The differential earnings rate is the excess of "imputed earnings rate" for a taxable year over the "aver mutual earnings rate" for the second calendar year preceding calendar year in which the taxable year begins. As explai below, the "imputed earnings rate" is designed to provide compa ble treatment for stock and mutual companies.

Imputed earnings rate

The imputed earnings rate for 1984 was 16.5 percent. For taxa years beginning after 1984, the imputed earnings rate is an amo which bears the same ratio to 16.5 percent as the current st earnings rate (i.e., the numerical average of the rates of return the 50 largest stock companies for the 3 years preceding the c rent taxable year) bears to the base period stock earnings rate (i the numerical average of the rates of return for the 50 larg stock companies for 1981, 1982, and 1983).

The Congress anticipated that the 16.5-percent rate would res in the mutual segment of the life insurance industry bearing percent of the aggregate industry tax burden for 1984. The C gress believed that this was appropriate in the light of a number factors including the historic allocation of the industry's burden, the relative percentages of assets held by the stock a mutual segments of the industry, and the difference in treatm of mutual company policyholders and stock company shareho ers.[4] Because the Congress determined that the 16.5-percent r resulted in an appropriate allocation of the industry's tax burd for 1984 given these various factors, this rate is adjusted in prop tion to changes in the rate of return for large stock compan rather than replacing the imputed rate with one equal to t

[4] Earnings that are distributed by a stock company to its shareholders are included in inc by the shareholders. In contrast, in the case of a mutual life insurance company, earnings are distributed generally are not included in income by the policyholders.

ctual rate of return of a group of stock companies in subsequent ears. Specifically, the imputed earnings rate was indexed to ianges in the current stock earnings rate as compared to the average of the stock earnings rates for a base period of calendar ears 1981, 1982, and 1983.

tock earnings rate

The stock earnings rate for any particular year is the numerical verage of the earnings rates of the 50 largest stock life insurance ompanies. The numerical average of stock earnings rates is used i order to reduce the potential impact of any manipulation of the ite by a few large stock companies. The three-year period is used preclude the possibility of sharp rises or declines in the rate of turn for the stock segment of the industry, giving the mutual ompanies some ability to plan for and predict tax costs for purposes of marketing their products.

verage mutual earnings rate

The average mutual earnings rate for any year is the weighted verage of the rates of return for all mutual companies. The use of aggregate or weighted average reflects the structure of the ownship differential provision which, in effect, was structured in the 84 Act to treat the entire mutual segment of the life insurance dustry as a taxpaying "entity" required to bear approximately 55 rcent of the industry tax burden. The aggregate mutual life inrance company tax burden is statutorily prescribed by the imput-l earnings rate of 16.5-percent on equity for 1984 (and as thereafr indexed). The use of a weighted average mutual earnings rate determine the differential earnings rate ensures that the regular x (computed without the ownership differential provision and asming no tax preference items), plus any increase in tax owed due the application of the ownership differential provision, will meet e prescribed aggregate mutual company tax burden.

mputation of earnings rates

The earnings rate for any life insurance company is to be determined by the Secretary of the Treasury by reference to a compa-'s statement gain or loss from operations as a percentage of its erage equity base.

The statement gain or loss from operations is the net gain or loss om operations set forth in the annual statement, determined thout regard to Federal income taxes and with further adjustents for certain tax items. First, the statement gain or loss from erations must be adjusted by substituting the amount of the dection for policyholder dividends for the amount shown on the nual statement for policyholder dividends unreduced by any different earnings amount. In addition, the statement gain or loss om operations is determined on the basis of tax reserves, rather an statutory reserves.

In calculating the stock earnings rate or the average mutual rnings rate, the Secretary is to take into account companies that ay be operating at a loss and, in effect, have a negative rate of turn, as well as companies that are operating on a profitable sis. However, in order to eliminate distortions in the computation of the average earnings rate of the 50 largest stock compani, the Secretary has the authority to omit certain companies that, b- cause of a small equity base (for example, because the company close to being or is insolvent), would seriously distort the sto earnings rate.

Average equity base

The average equity base of a stock or mutual company is the a erage of (1) the equity base determined as of the close of the ta able year, and (2) the equity base determined as of the close of th preceding taxable year. The term "equity base" means an amou equal to the statutory surplus and capital plus any nonadmitted nancial assets, the excess of statutory reserves over tax reserve the amount of any mandatory securities valuation reserve, th amount of any deficiency reserve or voluntary reserve, and 50 pe cent of the amount of any provision for policyholder dividends (other similar liability) payable in the following taxable year.

The term "nonadmitted financial asset" does not include due an accrued investment income reported as a nonadmitted asset, inves ments in office furnishings or fixtures, or agents' balances owed t the company. Thus, for example, an amount of due and accrued in terest on defaulted bonds is not a nonadmitted financial asset, eve though the underlying defaulted bond may be a nonadmitted finan cial asset. In determining the excess of statutory reserves over ta reserves, the amount of statutory reserves should not include an amount attributable to deferred and uncollected premiums tha have not yet been included in life insurance gross income.

Policyholder dividends payable in the following taxable yea refers generally to the total amount set aside on the annual state ment for apportioned and unapportioned dividends. Only 50 pe cent of this amount is added to the average equity base because i was believed that, on average, only 50 percent of the total annua statement provision for policyholder dividends to be paid in the fo lowing year (whether accrued or unaccrued for tax purposes at th end of the taxable year) is fairly allocable as a liability for the cur rent year. Although a policyholder dividend may be paid at the en of a policy year, and not accrue for tax purposes until payment recognition of part of that dividend as a current liability to deter mine the equity of the company recognizes that a dividend that i paid, in theory, accrued to the policyholder in a financial sens over the entire policy year. Once the policyholder dividends hav actually been paid (for example, amounts left with the company a dividends on deposit and amounts paid back to the company as pre miums), such amounts are not included in policyholder dividend payable in the following taxable year. Likewise, any amounts se aside for policyholder dividends to be paid beyond the close of the following taxable year are not "payable in the following taxable year" and are included in the equity base in their entirety.

Amounts included in equity generally refer to and are valued as amounts shown on the annual statement of the company. However a classification or characterization of an item on a company's annual statement in an attempt to avoid these requirements is dis- regarded.

)ifferential earnings rate

The differential earnings rate for any taxable year is based on a omparison of the imputed earnings rate and the average mutual arnings rate for the second preceding year. This rule is necessary ecause, for any taxable year, the Secretary will not have the data equired to determine the average mutual earnings rate prior to ıe date a mutual company is required to file its Federal income ax return. However, when actual data becomes available, any dif-erence between the differential earnings amount for the second receding taxable year is to be taken into account as an addition to r deduction from income (before computation of the small life in-urance deduction) for the taxable year during which the Secretary etermines the average mutual earnings rate for the prior taxable ear. Because any additions to or deduction from income will be aken into account in the first year during which the actual differ-ntial earnings rate is recomputed, no interest payments are re-uired. If a company ceases to be a mutual insurance company in ny year, then any adjustment will have to be taken into account or the taxable year giving rise to the adjustment.

To simplify the administration of the ownership differential pro-isions for the initial years covered by the 1984 Act, the Act provid-d a fixed differential earnings rate of 7.8 percent to be used for urposes of filing returns for the 1984 tax year and for estimated axes for 1985.

Table 1 contains the various rates necessary to determine the de-uction for policyholder dividends of mutual life insurance compa-ies for all years prior to 1988.

Table 1.—Data for Calculation of Section 809 Differential Earnings Rate

[Percent]

Year	Stock Earnings Rate [1]	Current Stock Earnings Rate [2]	Imputed Earnings Rate [3]	Average Mutual Earnings Rate	Differential Earnings Rate [4]	Recomputed Differential Earnings Rate [5]	"True-Up" Rate on Subsequent Year Returns
1987	NA	[6] 18.533	[6] 16.782	NA	[6] 3.647	NA	NA
1986	[6] 20.185	17.983	16.285	[6] 17.985	10.539	[7] 0	[7] −10.539
1985	18.683	18.026	16.323	13.135	6.157	3.188	−2.969
1984	16.731		[8] 16.5	5.746	[8] 7.8	10.754	2.954
1983	18.535			10.166			
1982	18.812						
1981	17.316						

[1] Unweighted earnings rate of the top 50 stock life companies in the current year.
[2] Preceding three-year average of the stock earnings rate.
[3] Equal to 0.9055 of the current stock earnings rate (CSER), since the imputed earnings rate is .165 times the ratio of the CSER divided by the base period (1981-3) stock earnings rate (18.221).
[4] Equal to the imputed earnings rate minus the average mutual earnings rate from two years earlier.
[5] Equal to the imputed earnings rate minus the average mutual earnings rate from the same year.
[6] Tentative.
[7] In Notice 88-106, 1988-40 I.R.B.1, the IRS stated that Treasury regulations will provide that the differential earnings rate and the recomputed differential earnings rate may not be negative.
[8] Set by statute.

Source: IRS, Revenue Ruling 87-98 and Announcement 88-47. Department of the Treasury, Office of Tax Analysis, June 1988.

·eatment of stock life insurance subsidiaries

Certain modifications to the equity base are required if a mutual 'e insurance company owns one or more subsidiaries that are life ɜurance companies. Such subsidiaries are generally treated as ›ck life insurance companies in computing such subsidiaries' tity level income tax liability. However, for purposes of comput- ʒ the differential earnings amount, a mutual parent of a subsidi- y life insurance company is required to include the equity of ch company in its own equity base (in lieu of the value of the ›ck of the subsidiary).

For purposes of determining the statement gain or loss from op- ɜtions of the mutual parent, the mutual parent does not take :o account any dividends it receives from the subsidiary. Also, for rposes of computing the average mutual earnings rate and the puted earnings rate, life insurance subsidiaries of a mutual life ıurance company are treated as mutual companies. If a subsidi- y life insurance company is owned by more than one mutual tity and is not a member of an affiliated group, the Secretary is provide adjustments that are to be made in the equity bases of ıtual life insurance companies owning stock therein to carry out ; general rules described above.

Γhis treatment is in contrast to the treatment of nonlife insur- ce subsidiaries, the stock of which is included in the parent ıtual company's equity and the earnings of which are only taken o account in computing the average mutual earnings rate when d as dividends are received by the parent mutual company.

E. Studies Required by the 1984 Act

Γwo issues that were of concern during the modification of the ucture of life insurance company taxation in 1984 were (1) the ount of Federal income tax paid by the life insurance industry, d (2) the relative Federal income tax burden borne by mutual insurance companies and stock life insurance companies. The ıgress determined that these two issues should be closely scruti- ed, and, thus, the 1984 Act instructed the Treasury Department prepare reports on these issues.

3eginning in 1985, the Secretary of the Treasury was required to ›mit an annual report on the revenues received under the life urance provisions for the most recent taxable year. Each report s to be submitted to the House Committee on Ways and Means l the Senate Committee on Finance. Each report was to present aggregate amount of revenue received for the most recent tax- e year for which data were available. The revenue received was be compared with the revenue anticipated as a result of the ınges made by TEFRA in 1982 and the 1984 Act. In addition, the ort was to provide the reasons for any difference between the ual revenue received and the revenue anticipated when the Acts -e adopted. An analysis of revenue collected from life insurance ıpanies was included in the interim report submitted by the ·asury Department to the Congress on June 15, 1988.[5]

)epartment of the Treasury, *Interim Report to the Congress on Life Insurance Company Tax- :*, June 1988.

The Secretary of the Treasury, in consultation with the Ho
Committee on Ways and Means, the Senate Committee on Fina
and the Joint Committee on Taxation, was also instructed to c
duct a study of the effects of the provisions of the 1984 Act on
different segments and products of the life insurance indus
during 1984, 1985, and 1986.

This study was to include an analysis of the relative share
life insurance company taxes paid by mutual life insurance com
nies and stock life insurance companies. The study was also to c
sider any other data considered to be relevant by either stock
mutual life insurance companies in determining appropriate s
ment balance. Among the relevant variables for consideration w
the amounts of the following items for each segment of the ind
try: equity, life insurance reserves, other types of reserves, d
dends paid to policyholders and shareholders, pension busin
total assets, and gross receipts. Also, in preparing this study,
Treasury Department was to address the revenue impact of all
ing consolidated returns to be filed by life insurance compa
with nonlife or noninsurance companies. The study was to incl
an analysis of to what extent taxes paid by stockholders of life
surance companies affect proper evaluation of segment balance.

Finally, the study was to include an analysis of life insura
products and their taxation and an analysis of whether the tax p
visions in part I of subchapter L operate as a disincentive to gr
ing companies.

In order to conduct the study with as much information as po
ble, the Secretary of the Treasury was provided authority to
quire the reporting of data by life insurance companies. Also
was specifically provided that the general authority granted to
Treasury to gather information could be used to gather infor
tion on the volume and use of policyholder loans so that the c
mittees would have useful information for future legislative w
in that area.

The final report on the study is to be submitted by January
1989, to the Committee on Ways and Means and the Committee
Finance. Interim reports were to be submitted to the committ
not later than July 1, 1986, July 1, 1987, and July 1, 1988. The f
interim report was transmitted to the Ways and Means and
nance Committees on June 15, 1988.[6] A summary of the June 1
Treasury Department Report is in Part III, below.

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[6] *Id.*

I. SUMMARY OF 1988 TREASURY DEPARTMENT INTERIM REPORT ON LIFE INSURANCE COMPANY TAXATION

A. 1987 Treasury Survey

:kground

'he 1984 Act required the Treasury Department to submit re-ts on the Federal income taxes paid by the life insurance indus- and the relative tax shares paid by the mutual and stock com-.y segments. To comply with the 1984 Act, the Treasury Depart-ıt in 1987 conducted a special survey of life insurance compa-;. The results of this survey were presented in an interim report mitted to the Congress on June 15, 1988.[7]

vey design

he Treasury Department in June 1987 sent questionnaires to 50 largest mutual and 198 largest stock life insurance affiliated ıpany groups; the survey also was sent to a random sample of .ller mutual and stock company groups.[8] The survey excluded adian-owned, tax-exempt, and bankrupt life insurance compa-, and companies not taxed as life insurance companies for Fed- income tax purposes. A total of 322 companies were surveyed ı a final response rate of 98 percent. The figures presented in Treasury Report were computed by weighting the survey data each of the four sample groups (small and large mutual and k companies) by the sample rate for the group.

'parability with IRS and financial statement data

ıe survey data contained in the Treasury Report are not direct-ɔmparable to published data from IRS statistics of income or ncial statements. First, Federal income tax rules were used to ;ify firms as life insurance companies. Second, the provision for s shown on financial statements generally is not the same as amount reported on tax returns. Third, the survey data may be to show tax information for life insurance companies before olidation with nonlife affiliates.

B. Revenue Effect of 1984 Act

:ground

ıe 1984 Act directed Treasury to submit annual reports to Con-; on life insurance company tax revenues. These reports were .) compare the actual amount of revenue received from life in-

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partment of the Treasury, *Interim Report to The Congress on Life Insurance Company on,* June 1988.

;et data from A.M. Best Company, *1985 Life and Health Balance Sheet and Income State-'ape* ("Best Tape") were used to rank company groups by size.

surance companies with the amount of revenue that was antici ed to be received from these companies during the consideratio the Tax Equity and Fiscal Responsibility Act of 1982 ("1982 A and the 1984 Act; and (2) explain any differences between act and anticipated revenues.

Anticipated revenues

The Treasury Department estimates the revenue effect of legislation relative to a baseline revenue forecast. The baseline current forecast of revenues that would be received if present were not amended. The Treasury Department revenue baseline lizes the macroeconomic projections published by the Office Management and Budget.

The revenue effect of a tax bill is the estimated change in re nues relative to the baseline forecast. Consequently, the reve "anticipated" to be received if a tax bill is enacted is the sum the baseline revenue forecast plus the estimated revenue effect the bill.

Anticipated revenues may diverge from actual revenues beca either the baseline revenue forecast or the estimated revenue eff is inaccurate. Because the revenues that would have been recei had enacted legislation not been adopted cannot be measured, degree to which differences between anticipated and actual re nue are attributable to error in the baseline versus error in revenue estimate cannot be determined precisely.

Errors in forecasting baseline revenues may be caused by inc rect projections of macroeconomic variables such as interest rat inflation, and GNP growth. Baseline revenue forecasts for a p ticular industry also are prone to error when the industry's co petitive environment is undergoing rapid change (for examp when new products are introduced or new firms enter the ind try).

Error in estimating revenue effects can be caused by incorr projections of macroeconomic variables as well as insufficient da In addition, behavioral responses to new tax rules are extrem difficult to predict and may be a source of error in revenue e mates.

Treasury Department estimates of 1984 Act

Table 2, below, illustrates the Treasury Department's estima of life insurance industry tax receipts before and after the 19 Act, calculated as of June 1984. The Treasury Department estim ed that the 1984 Act would reduce aggregate tax receipts from l insurance companies by $0.5 billion in fiscal 1984, with the reven loss increasing to $1.2 billion by fiscal 1988. After taking into count the changes in the 1984 Act, life insurance company tax ceipts were projected to be $2.5 billion in fiscal 1984, increasing $3.8 billion in fiscal 1988.

The Treasury Department baseline estimates were determin on a life subgroup basis, i.e., excluding income of affiliated nonl companies, but taking into account the use of losses and cred from affiliated nonlife companies against the income and tax liab ity of affiliated life insurance companies.

'able 2.—Life Insurance Company Tax Liability After the 1984 Act: Comparsion of Treasury Estimate of June 1984 with Preliminary Results from 1987 Treasury Department Survey

[In billions of dollars]

Item	1984	1985	1986	1987	1988
'iscal Years					
Baseline before 1984 Act	3.0	4.0	4.3	4.6	5.0
1984 Act Changes	−0.5	−0.9	−1.0	−1.1	−1.2
Baseline after 1984 Act	2.5	3.1	3.3	3.5	3.8
'alendar Years					
Baseline after 1984 Act	3.0	3.2			
Tax after credits, per survey[1]	2.4	2.9			
Difference between baseline receipts and survey	−0.6	−0.3			

[1] Includes companies that file separate, life/life consolidated, or life/nonlife 'nsolidated returns. Tax computed after losses and credits from nonlife affiliates.

Source: Department of the Treasury, *Interim Report to The Congress on Life ·surance Company Taxation* (June 1988), pp. 12, 15.

The Treasury Department's baseline receipts forecast for the life ısurance industry immediately after the 1984 Act may be com- ıred with taxes paid by the life insurance industry in 1984 and)85, as determined in the Treasury Report. For calendar year)84, the Treasury Report indicates a revenue shortfall of $0.6 bil- ɔn: $2.4 billion of tax after credits as compared to the $3.0 billion ıat had been estimated in June 1984 (see Table 2). For calendar ɘar 1985, the shortfall was $0.3 billion: $2.9 billion of tax after 'edits as compared to $3.2 billion estimated in June 1984.

easons for revenue shortfall

The source of the shortfall in anticipated revenues from the life ısurance industry in 1984 is itemized in Table 3, below. For stock fe insurance companies (excluding stock subsidiaries of mutual fe insurance companies), the Treasury Department overestimated ɔth gain from operations and tax deductions (especially the allow- ɔle policyholder dividend and net operating loss deductions). As a sult of these offsetting errors, the Treasury Department's esti- ate of the stock segment's tax liability for calendar year 1984 osely conforms to the taxes actually paid by that segment.

Table 3.—Details of Life Insurance Industry Tax Liability, Calendar Year 1984

[In billions of dollars]

Item	Treasury Estimate of 1984 Act (June 1984)			Preliminary Result fro 1987 Survey [1]		
	Mutual	Stock	Total	Mutual	Stock	Tot
Gain from operations [2]	10.7	6.0	16.7	11.3	10.2	21
Total deductions	6.6	3.0	9.6	9.1	7.0	15
Allowed policyholder dividend deduction [3]	5.6	1.7	7.3	8.0	4.2	12
Net operating loss deduction	(4)	0.4	0.4	0.4	1.7	2
Small business deduction	(4)	0.2	0.2	0.1	0.2	0
Special life insurance deduction	1.0	0.7	1.7	0.6	0.9	1
Net income less deficit	4.1	3.0	7.1	2.2	3.2	5
Taxable income	4.2	3.1	7.3	2.3	3.4	5
Tax before credits	1.9	1.4	3.3	1.0	1.4	2
Less: Credits	0.3	0.1	0.4	(4)	(4)	0
Tax after credits	1.6	1.4	3.0	1.0	1.4	2

[1] Includes companies that file separate, life/life consolidated, or life/nonli consolidated returns. Stock life subsidiaries of mutual life companies are classifie as mutual life insurance companies.

[2] Before policyholder dividend and net operating loss deductions and aft income offset by nonlife losses.

[3] Treasury estimate of mutual segment's allowable policyholder dividends a sumed a $37.4 billion equity base and a 16.5% applicable imputed earnings rat

[4] Less than $50 million.

Source: Department of the Treasury, *Interim Report to The Congress on Li Insurance Company Taxation* (June 1988), pp. 13–14.

For mutual life insurance companies, the shortfall in the Treas ury Department's estimate of anticipated revenues is primarily du to a $2.4 billion underestimate of allowable policyholder dividend and a $0.4 billion underestimate of net operating loss deduction The Treasury Department attributes $0.4 billion of the $2.4 billio underestimate of allowable policyholder dividends to an overesti mate of the mutual segment's average equity base. The 1984 esti mate assumed an average equity base of $37.4 billion, while th ıctual average equity base reported to the Treasury Department or 1984 was $32.1 billion.[9]

The Treasury Department explains the overestimate of the 1984 nutual equity base as follows:

> First, the estimated equity was based on the "industry's" regulatory data which differs in scope and measurement from the tax definition used in section 809. The regulatory definition is generally broader than the tax definition. Second, the possible tax-minimizing behavior on the part of the mutual segment in reducing their equity as measured for section 809 purposes may have been underestimated.[10]

The Treasury Department explains its underestimate of net operting loss deductions in 1984 and 1985 as due to the pre-1984 Act aseline's failure to account fully for the temporary relief provions in the 1982 Act, the availability of consolidation after 1980, nd the recession in 1982–1983. The Treasury report states:

> The temporary relief provisions removed the limitation on deductions of policyholder dividends contained in the 1959 Act, permitting the accumulation of large net operating losses in 1982 and 1983. Some of these net operating losses were carried forward as deductions in 1984 and 1985 . . . [T]his effect of the 1982 Act was not apparent at the time the revenue estimates were made for the 1984 Act.[11]

egment balance

The Treasury Department's original estimates of the 1984 Act asımed that approximately 55 percent of life insurance industry tax evenues would be derived from the mutual segment of the life inırance industry and the remaining 45 percent from the stock segent. The Treasury Report shows that in actuality the balance of x liability between the segments is the reverse of what was origially anticipated for 1984 and 1985; approximately 45 percent of x liability was derived from the mutual segment while the reaining 55 percent was derived from the stock segment (see Table below). If the mutual segment's tax liability is adjusted for "trueps" occurring in the following tax year, the segment balance is ertic.

Under section 809, allowable policyholder dividends are reduced by the product of the differial earnings rate and the mutual equity base. Thus, a $5.3 billion overestimate of the mutual ıity base translates into a $0.4 billion underestimate of allowable policyholder dividends at 1984 differential earnings rate of 7.8 percent.

[10] Department of the Treasury, *Interim Report to The Congress on Life Insurance Company ation* (June 1988), p. 16.

[11] *Id*, p. 15.

Table 4.—Life Insurance Segment Balance, Calendar Years 198 1985: Comparsion of Treasury Estimate of June 1984 with Pr liminary Results from 1987 Treasury Department Survey

Item	Mutual [1]	Stock	Tot
Calendar Year 1984			
Treasury Estimate, June 1984			
Amount (billions)	$1.6	$1.4	$3
Percent	53	47	1
Treasury Survey, 1987			
Before "true-up":			
Amount (billions)	$1.0	$1.4	$2
Percent	42	58	1
After "true-up":			
Amount (billions)	$1.35	$1.4	$2.
Percent	49	51	1
Calendar Year 1985			
Treasury Estimate, June 1984			
Amount (billions)	$1.7	$1.4	$3
Percent	55	45	10
Treasury Survey, 1987			
Before "true-up":			
Amount (billions)	$1.3	$1.6	$2
Percent	45	55	10
After "true-up":			
Amount (billions)	$0.6	$1.6	$2
Percent	27	73	10

[1] Includes stock subsidiaries of mutual life companies.

Source: Department of the Treasury, *Interim Report to The Congress on Li Insurance Company Taxation* (June 1988), pp. 13–17.

The Treasury Report concludes that the greater than expecte tax liability of the stock segment for 1985 is primarily attributabl to the large amount of capital gains realized in that year. Th Treasury Report also concludes that the overestimate of th mutual segment's tax liability for 1985 is explained by a combina tion of factors including (1) lower than expected earnings growth (2) larger than expected net operating losses; and (3) larger tha expected policyholder dividend deductions, as was the case for 198

The Treasury Report states that the policyholder dividend deduc tion appears to have been underestimated as a result of a smalle than expected mutual equity base and a larger than expected stoc earnings rate (unweighted earnings rate of the top 50 stock lif companies) during the base period (1981–1983).[12] The Treasur Report speculates that the lower than expected earnings growth o the mutual segment could be due to a change in the mutual seg ment's share of the insurance market, which was not contemplate

[12] The base period stock earnings rate enters into the denominator of the imputed earning rate: a larger than expected base period stock earnings rate causes a smaller imputed earning rate; a smaller differential earnings rate; and thus a larger policyholder dividend deductio than expected.

the 1984 baseline, or to tax-minimizing behavior not taken into count in the 1984 revenue estimate.

easury Report conclusion

The Treasury Report concludes that tax payments of the life inrance industry and the relative shares paid by the mutual and ›ck segments in 1984 and 1985 did not meet Congressional expections at the time of the 1984 Act. The report states:

> In part, these shortfalls are attributable to: (1) the complexity of the life insurance industry and their [sic] tax rules; (2) the significant changes in the practices, products, and tax rules during the last decade; and (3) the possible underestimation of the industry's tax minimizing behavior in response to changes in the 1982 and 1984 Acts.[13]

e Treasury Report does not contain any conclusions regarding data. The report states ". . . it is more appropriate for tax legation to attempt to measure accurately the taxable income of npanies than to attempt to collect a particular amount of revee from an industry or from the different segments of an intry."[14]

Several factors should be considered in the interpretation of the a contained in the Treasury Report. First, the data are prelimiry and have not been fully verified by the Treasury Department. ond, the data do not reflect amendments and audit adjustments 1984 and 1985 tax returns made after the date of the Treasury vey. Third, the revenue estimates are shown on a consolidated sis, whereas the Treasury Report states that "... it may be approate to examine the [effect of] tax law ... [on] the life subgroup ore consolidation with non-life companies."[15] Fourth, the data not include taxes paid by stockholders of life insurance compas (policyholders in the case of mutual life companies) with rect to such stock. Last, tax minimizing behavior in the life insure sector, such as an increase in tax-exempt bond ownership, y increase tax liability in other sectors (as a result of reduced nership of tax-exempt bonds in these sectors). Thus, a portion of revenue change attributable to the insurance provisions of the 4 Act could be reflected on the tax returns of taxpayers other in life insurance companies.

C. Historical Data Relating to Life Insurance Company

Segment Balance

ckground

'he Deficit Reduction Act of 1984 directed the Treasury Departnt to submit to Congress three interim reports and a final ort with respect to life insurance company segment balance. ıong other things, these reports were to include: (1) an analysis he portion of the taxes paid by mutual and stock life insurance

Treasury Report, p. 18.
Id.
Id., p. 15.

companies; and (2) any other data relating to segment balance s
as equity, reserves, dividends, pension business, total assets,
gross receipts.

Historical segment balance data

The 1987 Treasury survey of life insurance companies only lected information for 1984 and 1985. Therefore, the Treas Report relied on financial statement data to analyze trends in ment balance. For this purpose, the American Council on Life surance ("ACLI") tabulated information on financial stateme with adjustments to (1) include U.S. branches of Canadian com nies, (2) exclude companies not taxable as life insurance compan and (3) include stock company subsidiaries of mutual companies the totals for mutual companies.

Table 5 contains segment data on life insurance premium inco and gross assets for 1970 through 1984. Both the premium asset data illustrate that the life insurance industry has grown s stantially between 1970 and 1984, and that the stock segment grown more rapidly than the mutual segment. Over the 1970-1 period, mutual company premiums increased 8.1 percent annua and mutual company assets increased 7.7 percent annually. By c trast, over the same period, stock company premiums increas 11.2 percent annually and stock company assets increased 11.8 p cent annually. As a result, over the 1970-1984 period, the mut company share of premium income declined from 53 to 43 perce and the mutual company share of assets declined from 68 to 56 p cent.

The mutual company share of premium income is consisten lower than the mutual company share of assets. The Treasu Report attributes this to the fact that mutual companies issue higher proportion of cash value life insurance than stock com nies.

Table 5.—Assets and Premium Income of All Life Insurance Companies, 1970–1984, Tabulated by the American Council on Life Insurance[1]

[Dollar amounts in billions]

Year	Premium Income				Gross Assets			
	Amount		Percent		Amount		Percent	
	Mutual	Stock	Mutual	Stock	Mutual	Stock	Mutual	Stock
1970	$19.3	$17.1	53.0	47.0	$142.0	$65.4	68.5	31.5
1971	21.2	19.2	52.5	47.5	150.4	71.6	67.7	32.3
1972	22.8	21.2	51.8	48.2	160.8	78.5	67.2	32.8
1973	24.6	23.6	51.0	49.0	166.9	84.6	66.4	33.6
1974	26.5	25.4	51.1	48.9	172.7	89.4	65.9	34.1
1975	29.5	28.4	50.9	49.1	188.0	99.6	65.4	34.6
1976	33.0	32.6	50.3	49.7	206.1	112.9	64.6	35.4
1977	35.6	35.6	50.0	50.0	221.8	126.5	63.7	36.3
1978	38.4	39.4	49.4	50.6	241.9	143.7	62.7	37.3
1979	40.0	43.8	47.7	52.3	264.2	163.3	61.8	38.2
1980	41.5	49.8	45.5	54.5	288.8	184.7	61.0	39.0

Table 5.—Assets and Premium Income of All Life Insurance Companies, 1970–1984, Tabulated by the American Council on Life Insurance[1] —Continued

[Dollar amounts in billions]

Year	Premium Income				Gross Assets			
	Amount		Percent		Amount		Percent	
	Mutual	Stock	Mutual	Stock	Mutual	Stock	Mutual	Stock
1981	41.1	63.1	39.4	60.6	309.0	210.1	59.5	40.5
1982	44.0	75.0	37.0	63.0	336.2	243.7	58.0	42.0
1983	47.1	70.4	40.1	59.9	366.2	277.9	56.9	43.1
1984	57.8	75.6	43.3	56.7	401.2	311.5	56.3	43.7
Growth rate, 1970–1984 (percent)	8.1	11.2			7.7	11.8		

[1] Tabulated from annual statements and Best's Reports by ACLI. Annual statement information adjusted to exclude amounts for companies not taxable as life insurance companies, to include amounts for U.S. branches of Canadian companies, and to include amounts for stock subsidiaries of mutual life insurance companies in the totals for mutual life insurance companies.

NOTE.—These data may not be comparable to the 1987 Treasury Department survey.

Source: Department of the Treasury, *Interim Report to The Congress on Life Insurance Company Taxation* (June 1988), pp. 45, 50.

gment balance data for 1985

The 1987 Treasury Department survey collected segment balance formation from a large sample of life insurance companies for 84 and 1985. The 1987 Treasury Department survey shows that, r 1985, the mutual company share of premium income was 44.1 rcent and the mutual company share of gross assets was 55.8 rcent (see Table 6, below). These data are very similar to the 84 data compiled by ACLI (see Table 5).

Table 6.—Life Insurance Company Segment Balance Data Tabulated from 1987 Treasury Survey, 1985 [1]

[Dollar amounts in billions]

Item	Amount			Percent		
	Mutual	Stock	Total	Mutual	Stock	Total
Information from Forms 1120 and 1120L [2]						
Taxable income:						
After nonlife losses	$3.398	$4.034	$7.432	45.7	54.3	100.0
Before nonlife losses	3.627	5.076	8.703	41.7	58.3	100.0
Tax before credits:						
After nonlife losses	1.373	1.648	3.022	45.4	54.6	100.0
Before nonlife losses	1.482	2.119	3.601	41.2	58.8	100.0
Tax after credits:						
After nonlife losses	1.282	1.601	2.883	44.5	55.5	100.0
Information from Form 8390 or Annual Statement [2]						
Gross assets	449.7	356.5	806.2	55.8	44.2	100.0
Equity [3]	34.1	44.9	79.0	43.2	56.8	100.0
Information from Form 1120L						
Gross less return premiums	72.1	91.2	163.3	44.1	55.9	100.0
Life insurance reserves [4]	251.9	171.1	423.0	59.6	40.4	100.0
Other reserves [4]	91.0	68.8	159.8	56.9	43.1	100.0
Information from Annual Statements						
Federal income tax incurred:						
Including capital gain	2.081	2.278	4.359	47.7	52.3	100.0
Excluding capital gain	1.414	1.830	3.244	43.6	56.4	100.0
Insurance in force	3,301	3,898	7,199	45.9	54.1	100.0

[1] Mutual includes stock subsidiaries of mutual life insurance companies.

[2] Form 1120 is the corporate income tax return, Form 1120L is the income tax return for companies taxed as life insurance companies, and Form 8390 is the information return for determining the differential earnings rate under section 809.

[3] For companies completing Form 8390, equity is the average equity base reported on the survey. For other companies, equity is capital and surplus minus investment in life company subsidaries, plus the average mandatory security valuation reserve, plus one-half of the average provision for policyholder dividends.

[4] Figures are average of beginning and end of year reserves.

Source: Department of the Treasury, *Interim Report to The Congress on Life Insurance Company Taxation* (June 1988), pp. 23, 31.

Table 6 illustrates that before nonlife losses, the mutual com ny share of Federal income tax liability before credits was appr mately 41 percent in 1985. After consolidating nonlife losses, h ever, the mutual company share of tax liability was 45 perc The implication of these data is that stock companies are able shelter a higher proportion of life insurance company income w nonlife affiliate losses.

Table 6 also shows that taxes reported on financial stateme are higher than tax liability shown on income tax returns. Treasury Report notes that taxes on financial statements are e mates of tax liability and may include deferred tax reserves allow for timing differences and for audit adjustments. Consoli tion on financial and regulatory statements also may differ fr consolidation permitted on tax returns.