

Annuity Agreements
of
Charitable Organizations

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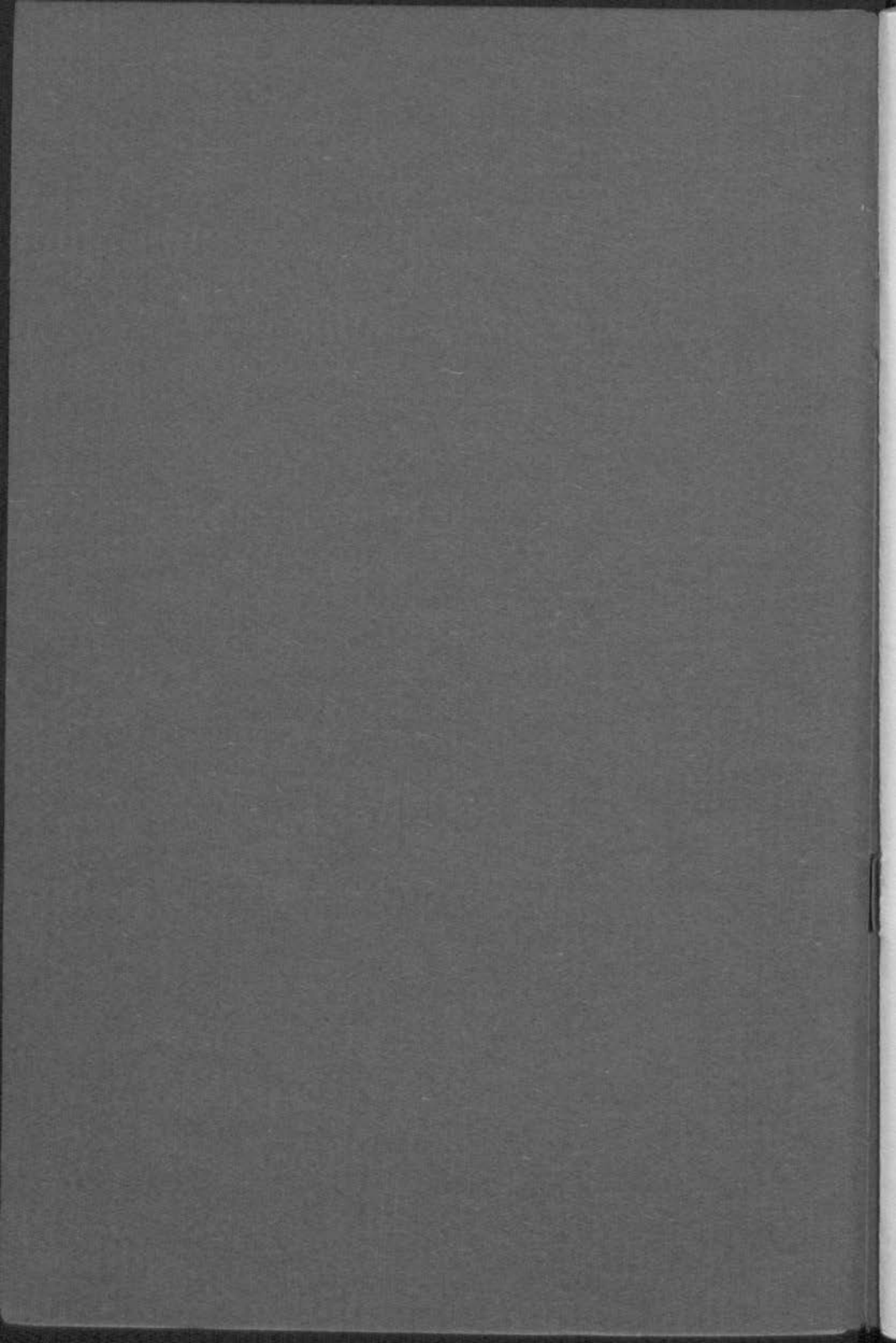
ANNUITY RATES AND
FEDERAL TAXATION OF
ANNUITIES

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FIFTH CONFERENCE

WISE PUBLIC GIVING SERIES, NO. 43

1934



Annuity Rates
and
Federal Taxation of Annuities

PAPERS PRESENTED AT A
FIFTH CONFERENCE ON ANNUITIES
HELD IN NEW YORK, N. Y.
NOVEMBER 20, 1934

Under the Direction of
THE SUB-COMMITTEE ON ANNUITIES OF THE
COMMITTEE ON FINANCIAL AND FIDUCIARY MATTERS
(To Study and Promote Wise Public Giving)

FEDERAL COUNCIL OF THE CHURCHES
OF CHRIST IN AMERICA
105 EAST 22ND STREET, NEW YORK, N. Y.

WISE PUBLIC GIVING SERIES No. 43

1934

REPORTS OF THE CONFERENCES ON ANNUITIES

held under the direction of the

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FOREWORD

THE fifth Conference on Annuities held under the direction of the Sub-committee on Annuities of the Committee on Financial and Fiduciary Matters of the Federal Council of the Churches of Christ in America was held at the Governor Clinton Hotel in New York City November 20, 1934. The conference was attended by eighty-two delegates, representing twenty-one denominations and eighteen other religious, charitable and educational organizations and institutions. Delegates came from Canada and from the following States: Massachusetts, Connecticut, New York, New Jersey, Pennsylvania, Maryland, West Virginia, Ohio, Indiana, Illinois, Minnesota, Iowa, Kentucky, Tennessee, Florida, Texas.

The conference was called because of the urgent request which the committee had received from many organizations desiring a uniform schedule of annuity rates which should be more in accordance with the objective of an average residuum of 70%, which was impossible to obtain by using the prevailing schedules of rates because of the low income on safely invested securities.

The program of the conference was limited to a consideration of annuity rates and the recent change in the Federal Law as regards the taxation of annuities. Previous conferences had considered various phases of the annuity business, the reports of which were printed and copies of which are still available. They constitute a valuable compendium of information on the annuity plan as used by religious, charitable and educational organizations and institutions for securing gifts. The price of each report is fifty cents. See list of the Conference Reports on opposite page.

Dr. Alfred Williams Anthony, Chairman of the Committee on Financial and Fiduciary Matters, who had attended all the previous conferences on annuities, was unable to be present on account of illness, and his presence and counsel were very much missed. Dr. Samuel McC. Cavert, General Secretary of the Federal Council of the Churches of Christ in America, brought a brief message commending the work done by the Committee on Annuities and others who for several years had very thoroughly studied annuities from many angles and had made the results of their studies available in printed form.

The conference began at ten o'clock in the morning and lasted until five o'clock in the afternoon. During the luncheon hour denominational groups met for consideration of the proposed uniform schedule of annuity rates which had been presented at the morning session of the conference. There was general expression of opinion that a uniform schedule of rates is desirable and that the schedule should be lower than the schedules being used by most organizations. After discussion concerning the rates proposed by the committee, the following action was adopted without any dissenting vote:

"That this conference express approval of the uniform maximum rates proposed by the Committee on Annuities and amended by vote of the conference, and record its conviction that such uniform rates should be adopted by all religious, charitable and educational organizations and institutions using the annuity plan for securing gifts."

The committee had proposed a rate of 2.5% for younger ages up to 30 years of age. The conference voted that the rate should be changed to 3% for ages up to and including 35 years of age.

Previous to the conference several organizations had undertaken an actuarial study of their annuities, but those studies had not been completed, and only partial information concerning them could be given. The results of the completed studies have been included in the paper on "The Mortality Among Annuitant Lives." The work of completing those studies has delayed the publication of the report of the conference, but the information gained from the completed studies makes the paper of far greater value. Letters from the Treasury Department in Washington received since the conference was held have been included in the paper on "Federal Taxation," which letters clear up certain points on which final rulings had not been given.

Since the conference was held several denominations have reported to the Committee on Annuities that they have adopted the proposed schedule of rates. Several interdenominational and undenominational organizations have also adopted them. Others have the schedule under consideration. It now appears that the objective of a uniform schedule of rates, which the Committee on Annuities has been endeavoring to secure for several years, is to become an accomplished fact and that the schedule here presented will be quite generally adopted.

ERNEST F. HALL.

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THE MORTALITY AMONG ANNUITANT LIVES

GEORGE A. HUGGINS

Consulting Actuary, Philadelphia.

If an organization accepts \$1,000 from a contributor, and agrees to repay the contributor, at a fixed annual sum until the principal is repaid—for example, \$100 a year for a period of 10 years, without any additional allowance for interest earnings—the problem of the organization is that of investing the principal sum so that it will be secure.

If the organization agrees to return the principal and the interest earnings in annual instalments of \$100 each, and bases its calculations on assumed earnings at the rate of 4%, then the problem of the organization is not only to keep its principal funds secure, but also to keep them invested in such a way that there will be interest earnings at the rate of 4%.

However, if the organization agrees to pay \$100 a year, not for a fixed term of years, as above outlined, but during the future lifetime of the contributor, then a third element has been introduced, and that is the duration of the life of the contributor. This is generally referred to as the "life contingency."

In other words, whenever the duration of the future periodical payments is contingent upon the future lifetime of one or more persons, the life contingency has been introduced into the picture.

The problem of investing the principal for security, and also in order to obtain the desired interest earnings, has been just considered under the able leadership of Dr. Gross. We will now give our attention to this problem of Life Contingencies, as affecting annuity agreements.

If we were to make a promise to continue payments during the future lifetime of one life and no other, then we would be very greatly concerned as to the future lifetime of that individual, for a long-lived individual might cause heavy loss to the organization, while in the case of a short-lived individual there might seemingly be an injustice done to the individual, because of the gain to the organization, resulting from the early

death. We do know, from our tables, the average duration of the future lifetime of persons at different ages as revealed by these tables, but how few, if any, would ever live exactly the average duration of his future life.

If the organization makes a promise to each of two lives, then our concern becomes that of the future lifetimes of the two lives, and it might happen that one would be a long-lived individual and the other would be a short-lived one, and for the two, the results would be about a fair average. And so it goes! As we add lives to the group under observation, we get a better distribution of the ages at which they enter upon their annuities and a better distribution as to the amounts of the annuities on the several lives, and a more normal average duration of life among the group as a whole, for the effect of those surviving a considerable period is offset by those of the group who pass out in comparatively short periods. This is what we refer to as the "spread," or "distribution of risks."

It is quite apparent, therefore, that the larger a group under observation, the less concerned we have to be as to the longevity of the individual, but, of course, if each individual has greater longevity than we expected, the group as a whole will have a greater average longevity than expected. This is the problem before us in considering longevity among annuitant lives. Are they living longer than we expected them to live?

First of all, the people who make annuity agreement gifts to religious, charitable and educational organizations are, as a group, a select class of lives. They represent the higher type of our citizenry, and, generally, they have been careful, abstemious livers and spenders, or they would not have attained the ages which they have. Nor would they have accumulated the funds with which they are enabled to make their gifts.

Out of this select class of lives, we have those who elect to make annuity gifts, and it is only natural and human that they would do so with the expectation of living a reasonably long life. Insurance companies selling annuities do not find that persons in ill health are the ones who buy annuities. This is what we call the "selection," and, naturally, it is always in favor of the selector and against the selectee. Of course, individuals guess wrong as to their own future lifetime, and there are frequent tragic illustrations, but, on the whole, as a group, they guess to their own advantage and, therefore, mortality studies among annuitant lives have shown that this careful selection,

made by members of a select group, produces a group of annuitant lives whose longevity exceeds that of insured lives. In other words, the rates of mortality are lower than those experienced on insured lives.

Perhaps I can express this selection by saying that those who insure expect that they may die early, and insure against that contingency, while those who purchase annuities expect to live long, and they insure against that contingency. This selection has a far greater influence on the mortality among the two groups than one would think at the outset.

We have another element among annuitant lives, namely, years of experience have shown that the longevity among women annuitants is greater than among men annuitants. Undoubtedly, this is largely due to a more highly developed instinct among the female lives than among the male lives. In other words, women out-guess the men on this point—as well as on many others. There are, of course, physiological reasons, but it does seem as if the initial selection by the individual is the greatest influence of all.

You will find, if you study the annuity rates of life insurance companies, that, for a given sum of money, paid in at a certain age, the companies will pay a smaller annuity to the female life than they would pay to the male life. This is not an injustice to the female lives, because, as a group, while they receive smaller annual payments, they receive them over longer periods, and, in the aggregate, the results are equivalent.

In discussing problems involving life contingencies, we hear frequent reference to the "expectation of life," or "life expectancy," as some prefer to call it. "The expectation of life" is the average number of years of the future lifetime of a group of persons, coming under observation at a given age.

For example, at age 40, according to the Combined Annuity (Female) Table, the expectation of life is 34.60, so that the average age at death of this group is 74.60. At age 50, the expectation is 26.07, so that the average age at death of this group is 76.07. At age 70, the expectation is 12.17, so that the average age at death is 82.17. At age 80, the expectation is 7.37 years, so that the average age at death is 87.37.

The reason that this average age at death advances, as the groups under observation increase in age, is that in any group some will die early and some in the later years, so that, as the so-called entry-age increases, we have the elimination of

those who died prior to that age, and the survivors are the longer-lived members of the earlier group.

While years of expectation are a guide in considering the questions relating to mortality, nevertheless, they cannot be used in the calculation of rates for the simple reason that, in converting life contingencies into money, that is, into dollars and cents, rates of interest must be injected and the effect of the interest or the discount, as the case may be, varies according to the future duration of a particular life; that is the incidence of the claim, and, therefore, the distribution of the death in a given group must be considered rather than the time at which, on the average, the entire group would pass out.

For comparative purposes, we show, in Schedule A, (page 17), the Years of Expectation of Life, according to a number of standard tables of mortality. Naturally, in a group such as that which we are considering, where the annuitant lives are predominantly female, we may expect a low rate of mortality, and, therefore, longer periods of life-expectancy than those shown by tables involving higher rates of mortality.

It will be observed that, at age 70, the life expectancy, according to the Combined Annuity Table, Female, is 12.17 years; which is only slightly less than that shown on the American Annuitants Select Table, Female, where it is 12.23; and a little less than that shown by the Female Table of the British Offices Annuitant Lives, which is 12.86.

At age 75, the Combined Annuity Table shows 9.57, as compared with the American Annuitants 9.79, which happens to be exactly the same as the British Offices Annuitants.

At age 80, the Combined Annuity Table shows 7.37 years, against the American Annuitants 7.72, and the British Offices Annuitants 7.18.

The table that is recommended by the Committee on Annuities, as the basis for the calculated annuity rates, is the Combined Annuity Table, Female Lives, which is to be used as a basis for male lives as well as for female lives. This gives a margin over the male lives, to go towards the excess mortality costs, if any, on the female lives, in the event of an actual mortality rate on those lives lower than the tabular rate.

It is a matter merely of collateral interest to note that the Carlisle Table, based upon the population of Carlisle, England, from 1779 to 1787, shows life expectancies that do not vary very

much from those of the McClintock's Table of Mortality among Male Lives, nor those of the American Experience Table. In fact, at some ages, the periods are practically identical.

The Combined Annuity Table is so constructed that it is of comparative ease for valuation purposes. Instead of having entirely separate tables of mortality among male and female lives, the table is the same, except that it is entered at an age four years younger for the female lives, as compared with the age of the male lives, therefore, any factor in the table that applies to a male life at age 74, will apply equally to a female life at age 70, and so on throughout the table.

Furthermore, calculations have been made and factors arrived at, showing the number of years to be added to the older of two lives, in order to get a single life which, according to the table, is the equivalent of two lives.

For example, at ages 65 and 60, the difference is 5 years; the correction is 7 years, to be added to the older age (65), giving 72 years as the age of a single life that is the equivalent of the two lives. I do not mean to say that this device will give one the basis of arriving at a joint life and survivor rate, corresponding to two given ages, but it is a great help in calculating such rates, since it applies in arriving at the cost of an annuity continuing during the joint lifetime of two lives.

The calculation of annuity costs, as above explained, is a combination of life contingencies and interest earnings, and from this combination we get the factors for calculating the annuity rates.

An important study has been made of the mortality experience among lives that are the recipients of annuities in connection with gift annuity agreements. The results of this study have been made available for this paper.

The data has been contributed by 14 Boards of three of the larger Protestant denominations. The total number of annuity agreements included in the study was 6,631, representing total gifts of \$11,793,008. While the bulk of this experience lies within the last 20 years, yet some of the Boards contributed their entire experience, running back 60 years in one case.

The aggregate amount of the annuity payments which these gifts represent is \$763,965, so that there is in all an amount of data that was well worth while studying.

An analysis of the gifts according to the kind of annuity, that is, whether single life or joint life and survivor, and according to sex, and with the corresponding averages, is as follows:

<i>Kind of Annuity</i>	<i>No. of Annuities</i>	<i>Amounts of Gifts</i>	<i>Average Gift</i>
SINGLE LIFE:			
Male	891	\$ 1,865,478	\$2,094
Female	3,661	5,401,228	1,475
Total	4,552	\$ 7,266,706	\$1,596
TWO-LIFE:			
Male and Female	1,314	\$ 3,017,531	\$2,296
Female and Female	719	1,429,601	1,988
Male and Male	46	79,170	1,721
Total	2,079	\$ 4,526,302	\$2,177
Combined Totals	6,631	\$11,793,008	\$1,778

It will be noted from the above that the number of single-life gifts exceeds the number of the two-life gifts by more than two to one. The single-life gifts are predominantly female, the ratio being more than four to one. The single-life female gifts are greater in number than all the others combined.

In the case of the two-life gifts, the male and female lives predominate, being nearly two to one, but there are also a considerable number of gifts involving two female lives. The number of two-life male gifts is almost negligible. Here again, therefore, the female donors predominate.

As a matter of interest, the average amount of the gifts in each of the several groups has been shown above. For the entire group the average gift is shown to be \$1,778. The two-life, male and female, gifts had the highest average, \$2,296. The two-life gifts average higher than the single-life gifts; \$2,177, as compared with \$1,596. The lowest average was \$1,475 for the single-life, females; but this group more than made up in volume for what was lacking in the average gift.

In Schedule B (page 18) there are shown the number and amount of the gifts by age groups, classified, in the case of the single-life gifts, according to the ages of the donors at the time the agreements were entered into. In the case of the two-life gifts, they are scheduled according to the ages of the lives classified as "prime" lives, that is, the ages of the donors, as

nearly as could be ascertained, regardless of the ages of the secondary lives named in the agreements.

From this schedule it is apparent that the number and amount of gifts received from younger people is comparatively insignificant, as compared with the number and amount of gifts from older donors.

The largest number of gifts in one age group (1,324) appears in the group from 70 to 74, inclusive, with the largest amounts of gifts, (\$2,426,438) in the same age groups. At ages 65 and upwards, 4,150 gifts, or 62.6% of the total, were received for \$7,806,950, or 66.2% of the total.

It is, perhaps, to be expected that gifts should come from older donors, because they have reached the period of life where they have some accumulated funds, and are relieved, to a considerable extent, of family obligations, but at the same time they are interested in providing themselves with income for the later years of their lives. The facts brought out by these studies verify these deductions and expectations.

The incidence of the gifts, according to age and sex, was such that the mortality studies were deemed to be of greater value when related to the amounts of the gifts, the amounts of the annuities, and the sex and age, rather than merely a study of the rate of mortality among the lives.

The theory followed in the studies was, that the factor which counted most was, whether or not the so-called reserves released, upon the deaths of those receiving annuities, were actually higher or lower than the reserves expected to be released by the table of mortality used in the studies as the standard. For instance, if the group of lives under study are living longer than would be expected among such a group of lives, in accordance with the standard table of mortality, it means that the annuity payments would be continued to the group as a whole for a longer period than contemplated, and, therefore, the amounts of the reserves released by the actual deaths will be lower than those expected to be released had the deaths occurred exactly in accordance with the standard table.

Various studies were made with the individual groups and the combined groups contributing data, and it was clearly shown that the deaths for the groups as a whole were running lighter than those expected according to the standard table, which in this case was the Combined Annuity Table of Mortality.

It will be recalled that the Combined Annuity Table of Mortality is so constructed that it applies to male lives at the actual ages, and is applicable to female lives by setting back the ages 4 years. Naturally, as an age is set back to a younger age, a lower mortality is involved at the younger age than at the true age.

Various tests were made in connection with the data supplied by the several groups. In one case, involving nearly 3,800 gifts, when all ages, male and female, were set back 4 years, the ratio of reserves actually released by the deaths, to the reserves expected to be released, was 94.28. In another group, involving nearly 1,900 gifts, when all ages were set back 4 years, the corresponding ratio was 109.46. For these two groups combined, with nearly 5,700 gifts, the ratio was 100.10%. A smaller group, involving about 1,000 gifts, showed an unusually low mortality, 70.5%, when all ages were set back 4 years. When this group was combined with the other two, involving nearly 6,700 gifts, for nearly \$11,800,000 of funds, the combined average was 95.4%.

When all ages were set back 5 years, for the groups as a whole, the ratio of the reserves actually released to those expected to be released was 104.12%.

It is apparent, therefore, that for the three groups combined, the actual reserves released parallel closely the reserves expected to be released according to the rate of mortality, which corresponds to the setting back of all ages between 4 and 5 years as related to the Combined Annuity Table of Mortality.

In the preparation of data for studies such as this, one cannot always be sure that the records are correct as to the dates of deaths occurring among the second lives under two-life contracts, where the first life is still living. It is quite possible, therefore, that the actual reserves released are somewhat understated in these cases, because if the death of the second life has occurred, but it is not on record in the office, the gift is continued as a two-life case, without any reserve released by death, whereas, actually, it should be continued as a single life case, with some reserve released because of the death of the second life. It is, therefore, quite possible that, for this large group as a whole, the setting back of all ages for 4 years was an adequate adjustment. This is exactly the basis that was recommended by the Committee on Annuities for calculating

the tabular rates for the consideration of the Conference on Annuities, with interest at 4% and a 70% residuum.

There were adjustments made at the younger and the older ages, in the calculated rates, which will give a margin as compared with the tabular rates. These should offset any adverse variations in future mortality as compared with the Combined Annuity Table, with all ages—male and female—set back 4 years.

It was of considerable interest to note that, in the case of the two larger groups, the ratio of actual reserves released to expected was almost exactly 100%, with all ages set back 4 years, the combined figure being 100.1%. The average for the three groups, as shown above, was pulled down somewhat by the lower ratio obtaining in the smaller group.

When it came to the studies among the separate groups, such as the female single-life group, in order to get expected reserves released that parallel the actual reserves released by death, the ages had to be set back 7 years. This reveals a lower rate of mortality among female lives than contemplated under the Combined Annuity Table, where a set-back of 4 years is regarded as standard.

In the case of the single-life males, the reverse was true. The rate of mortality revealed was somewhat higher than the Combined Annuity Table, so that the adjustment in the ages to get the expected reserves released, paralleling the actual reserves released, was an advance in years rather than a set-back. In one group, a one-year advance was sufficient, but in another group 6 years was required.

For the joint-life cases, both sets of ages had to be set back from 4 to 5 years; a 4-year set-back running slightly under 100%, and the 5-year slightly over, so that a 5-year set-back on the joint-life cases gives a little margin.

It is apparent, from these studies of actual results, that the recommendations of the Committee on Annuities have been confirmed in that, by setting all ages back 4 years, rates would be obtained that would closely parallel the actual experience, even though it meant relying upon favorable margins, as compared with the standard table on the male lives, to offset the slightly unfavorable margins in the female lives, this being the case in both the single-life and the two-life cases.

On the basis of the mortality experience revealed in the above studies, and taking into account the amounts of the annuities provided for under the agreements, the kind of annuities, the ages, and the sexes of the donors, calculations were made to determine the average residuum expected to be released; and the figure arrived at was 48.89%. Similar calculations in another group showed 45.65%. The general average for the two groups was 47.82% of the amount of the original gifts. This combined study included nearly 5,700 gifts for slightly in excess of \$10,000,000.

These calculations showed that the annuity agreements which had pulled down the general average were the two-life cases, for in the one group the average residuum on the two-life cases was found to be 31.89%, and in the other 42.84%, with an average of 35.34% for the combined groups. There were nearly 1,900 two-life agreements in this study, for gifts approximating \$4,200,000. The low average residuum under these two-life cases is due, in part, to the low rate of mortality, but chiefly because of the too liberal annuity rates. For these same two groups combined, the average residuum calculated for the single-life male annuity agreements was 63.65%, and for the single-life females 54.16%.

It is quite evident, from the above studies, that it was most opportune for representatives of the leading organizations issuing annuity agreements to restudy and to reconsider the whole question of annuity rates, particularly with a view to reducing their schedules of rates on the two-life cases. This is due to the apparently increasingly low mortality experience among the group of donors, and also to the increasing difficulty of investing the funds, so as to keep the principal intact, and to maintain a rate of interest earnings in excess of 4%, which is the basis in the above studies.

The rates adopted by the Conference are designed to produce an average residuum approximating 70% on the two-life cases, as well as on the single-life cases, with a margin for contingencies involved because of the reduction in the scheduled rates at the lower and the higher ages.

SCHEDULE A
COMPLETE EXPECTATION OF LIFE
COMPARISON OF YEARS SHOWN BY VARIOUS TABLES OF MORTALITY

Age	Combined Annuity		American Annuity (Select)		McClintock's Annuity		British Offices		American Men Ultimate	American Experience	Carlisle Table of Mortality
	Male	Female	Male	Female	Male	Female	Male	Female			
30	40.00	43.62	37.78	40.77	35.11	40.65	—	—	37.70	35.33	34.34
35	35.49	39.09	33.75	36.71	31.60	36.55	—	—	33.51	31.78	31.00
40	31.10	34.60	29.81	32.71	28.07	32.47	31.49	35.19	29.32	28.18	27.61
45	26.89	30.24	25.99	28.80	24.56	28.45	27.69	31.41	25.22	24.54	24.46
50	22.91	26.07	22.35	25.03	21.11	24.53	23.83	27.57	21.29	20.91	21.11
55	19.19	22.14	18.92	21.44	17.78	20.76	20.09	23.73	17.62	17.40	17.58
60	15.79	18.49	15.76	18.08	14.64	17.21	16.63	19.94	14.29	14.10	14.34
65	12.74	15.15	12.90	15.00	11.75	13.94	13.48	16.28	11.34	11.10	11.79
70	10.06	12.17	10.38	12.23	9.18	11.00	10.64	12.86	8.81	8.48	9.18
75	7.78	9.57	8.21	9.79	6.96	8.44	8.14	9.79	6.69	6.27	7.01
80	5.88	7.37	6.40	7.72	5.13	6.30	6.17	7.18	4.99	4.39	5.51

COMBINED ANNUITY TABLE.—This table is based upon the experience among lives covered by policies of group life insurance, graded at the older ages into the experience among annuitant lives, as developed under the American Annuitants' Table. Therefore, it constitutes a table peculiarly adapted to use under group annuity policies, issued by insurance companies on the lives of persons actively engaged in some group or class of occupations. It has been adopted by the State of New York as a minimum standard for valuing annuities issued on and after January 1, 1931.

AMERICAN ANNUITANTS' TABLE.—This table was compiled from data contributed by twenty-five American and six Canadian life insurance companies. It covers the experience of these companies on 22,243 annuities issued on 14,868 lives. The mortality rates among male lives and female lives were derived separately. The results were published in the Transactions of the Actuarial Society of America.—October, 1927, Volume XXVIII, Part Two.

McCLINTOCK'S TABLE OF MORTALITY AMONG ANNUITANTS has been adopted as the standard for the valuation of annuity

contracts in many states. It was constructed in the year 1899 by McClintock on the basis of the experience of fifteen American companies.

BRITISH OFFICES TABLE OF MORTALITY AMONG ANNUITANTS is based upon the mortality experience of forty-nine insurance offices (chiefly British) among life annuitants during the period 1900 to 1920 inclusive.

AMERICAN MEN ULTIMATE TABLE OF MORTALITY is based upon the mortality experience among insured lives in the United States and Canada during the period 1900 to 1915, inclusive.

AMERICAN EXPERIENCE TABLE OF MORTALITY is based upon the mortality experience among lives insured during the first twenty years of the operations of the Mutual Life Insurance Company of New York. It has been adopted as the standard for the valuation of insurance contracts in many states.

CARLISLE TABLE OF MORTALITY is a historic table based upon the mortality experience among the population of two parishes of the City of Carlisle, England, from 1779 to 1787.

SCHEDULE B.

ANNUITY AGREEMENTS

*Distribution of Number and Amount of Annuity Agreements
By Kind of Agreements and Ages of Donors
at Dates of Gifts*

Age at Entry Groups	SINGLE LIVES		TWO LIVES		COMBINED TOTALS	
	Number of Gifts	Amount of Gifts	Number of Gifts	Amount of Gifts	Number of Gifts	Amount of Gifts
1 - 19 - -	10	\$ 3,312	5	\$ 6,200	15	\$ 9,512
20 - 29 - -	11	21,305	4	221,100	15	242,405
30 - 39 - -	57	52,730	22	16,739	79	69,469
40 - 49 - -	260	405,102	88	150,506	348	555,608
50 - 59 - -	706	1,064,919	301	523,566	1,007	1,588,485
60 - 64 - -	672	924,908	345	595,671	1,017	1,520,579
65 - 69 - -	823	1,426,506	367	941,911	1,190	2,368,417
70 - 74 - -	901	1,466,720	423	959,718	1,324	2,426,438
75 - 79 - -	623	903,390	278	594,892	901	1,498,282
80 - 84 - -	302	461,085	158	329,653	460	790,738
85 - 89 - -	148	355,950	58	114,846	206	470,796
90 - 94 - -	36	175,979	28	70,400	64	246,379
95 - 99 - -	3	4,800	2	1,100	5	5,900
TOTALS	4,552	\$7,266,706	2,079	\$4,526,302	6,631	\$11,793,008

UNIFORM MAXIMUM ANNUITY AGREEMENT TABLE
SINGLE LIFE

Calculated on basis assumed by Commissioner under 36, 1934
Using Uniform Annuity Mortality Table—1950
Interest at 4%—Males—Males Males at 70 years
and Other Ages

Age	Rate	Rate	Rate
20	5.00	5.00	5.00
21	5.00	5.00	5.00
22	5.00	5.00	5.00
23	5.00	5.00	5.00
24	5.00	5.00	5.00
25	5.00	5.00	5.00
26	5.00	5.00	5.00
27	5.00	5.00	5.00
28	5.00	5.00	5.00
29	5.00	5.00	5.00
30	5.00	5.00	5.00
31	5.00	5.00	5.00
32	5.00	5.00	5.00
33	5.00	5.00	5.00
34	5.00	5.00	5.00
35	5.00	5.00	5.00
36	5.00	5.00	5.00
37	5.00	5.00	5.00
38	5.00	5.00	5.00
39	5.00	5.00	5.00
40	5.00	5.00	5.00
41	5.00	5.00	5.00
42	5.00	5.00	5.00
43	5.00	5.00	5.00
44	5.00	5.00	5.00
45	5.00	5.00	5.00
46	5.00	5.00	5.00
47	5.00	5.00	5.00
48	5.00	5.00	5.00
49	5.00	5.00	5.00
50	5.00	5.00	5.00
51	5.00	5.00	5.00
52	5.00	5.00	5.00
53	5.00	5.00	5.00
54	5.00	5.00	5.00
55	5.00	5.00	5.00
56	5.00	5.00	5.00
57	5.00	5.00	5.00
58	5.00	5.00	5.00
59	5.00	5.00	5.00
60	5.00	5.00	5.00
61	5.00	5.00	5.00
62	5.00	5.00	5.00
63	5.00	5.00	5.00
64	5.00	5.00	5.00
65	5.00	5.00	5.00
66	5.00	5.00	5.00
67	5.00	5.00	5.00
68	5.00	5.00	5.00
69	5.00	5.00	5.00
70	5.00	5.00	5.00
71	5.00	5.00	5.00
72	5.00	5.00	5.00
73	5.00	5.00	5.00
74	5.00	5.00	5.00
75	5.00	5.00	5.00
76	5.00	5.00	5.00
77	5.00	5.00	5.00
78	5.00	5.00	5.00
79	5.00	5.00	5.00
80	5.00	5.00	5.00
81	5.00	5.00	5.00
82	5.00	5.00	5.00
83	5.00	5.00	5.00
84	5.00	5.00	5.00
85	5.00	5.00	5.00
86	5.00	5.00	5.00
87	5.00	5.00	5.00
88	5.00	5.00	5.00
89	5.00	5.00	5.00
90	5.00	5.00	5.00
91	5.00	5.00	5.00
92	5.00	5.00	5.00
93	5.00	5.00	5.00
94	5.00	5.00	5.00
95	5.00	5.00	5.00
96	5.00	5.00	5.00
97	5.00	5.00	5.00
98	5.00	5.00	5.00
99	5.00	5.00	5.00
100	5.00	5.00	5.00

Table 1001

UNIFORM MAXIMUM ANNUITY AGREEMENT RATES
SINGLE LIFE

Calculated on Basis Adopted by Conference November 20, 1934

Basis: Combined Annuity Mortality Table—Female
Interest at 4%—Residuum 70%—Rates Modified at Younger
and Older Ages

<i>Age</i>	<i>Rate</i>	<i>Age</i>	<i>Rate</i>
30	3.0%	56	5.1%
31	3.0	57	5.1
32	3.0	58	5.2
33	3.0	59	5.2
34	3.0	60	5.3
35	3.0	61	5.4
36	3.1	62	5.4
37	3.2	63	5.5
38	3.3	64	5.6
39	3.4	65	5.7
40	3.5	66	5.8
41	3.6	67	5.9
42	3.7	68	6.0
43	3.8	69	6.1
44	3.9	70	6.2
45	4.0	71	6.3
46	4.1	72	6.5
47	4.2	73	6.6
48	4.3	74	6.8
49	4.4	75	7.0
50	4.5	76	7.1
51	4.6	77	7.3
52	4.7	78	7.5
53	4.8	79	7.8
54	4.9	80 and over	8.0
55	5.0		

GAH:1934

LEWIS AND CLARK NATIONAL ANNUITY ASSURANCE RATE

TWO LIVES - JOINT AND SURVIVOR

Calculated on basis adopted by California Insurance Guaranty Association
 Joint Combined annuity payments - Two lives
 Interest at 4% - Standard 100 - Standard No. 1000 at Younger Age

Age of older life

Age of younger life	20	25	30	35	40	45	50	55	60	65	70	75	80	85	90
20	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
25	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
30	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
35	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
40	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
45	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
50	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
55	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
60	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
65	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
70	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

UNIFORM ANNUITY RATES

LEWIS T. REED

Secretary, The Annuity Fund for Congregational Ministers.

The Committee on Annuities has held frequent meetings during the past year, and has considered gravely and studiously the question of annuity rates. Discussion has been earnest and serious, and has embraced the many different angles from which the question of annuity rates must be approached. One significant conclusion has been definitely arrived at: the adoption of a uniform annuity rate by a considerable number of strong communions and organizations that are engaged in writing annuity contracts is of utmost importance from the point of view of fair dealing, Christian comity, and the good repute of Christian enterprises whose integrity is involved in the safeguarding of the vast sums committed to them under annuity contracts.

Although the three considerations that have been mentioned are of varying importance in the argument for uniform rates, all of them are valid and weighty. The removal of competition in seeking annuity gifts is a measure both of propriety and safety. A uniform schedule of rates is a valuable object lesson to the public in the ability of great institutions to govern themselves voluntarily by rules of fair dealing. A uniform schedule of rates will also be an impressive evidence that Christian enterprises covering a wide field cooperate in the vital matter of financial support. Christian goodwill is realistic when it is made effective in the field of finance. Most important of all is the greater safety of funds held under annuity contracts by the adoption of conservative rates by all our organizations after a painstaking examination of mortality risks and probable investment earnings. It need hardly be pointed out that any disaster to annuity funds in any one institution or society brought about by excessive annuity rates or rash investment would disturb public confidence in every fund that issues annuity certificates.

Deeply sensible of our common responsibility your committee has urged and brought about an examination of their annuity risks by a number of leading societies represented in

this conference, using the technical skill of highly valued actuaries and financial advisers. It is gratifying to learn that the results of the examinations that have been made have been invariably reassuring. The margin of safety has not been impaired, and has prevailingly been sufficient to yield a large benefit to the society holding the funds. This Committee, sponsored by the Committee on Financial and Fiduciary Matters of the Federal Council of the Churches of Christ in America, has held four conferences and may claim some credit for both the magnitude and the safety of the annuity gift business of missionary and benevolent societies and allied organizations. The recommendations of the committee have guided the action of many denominations and organizations represented in the conference.

At the present time it is frankly recognized that conditions are changing in the fields both of mortality and earnings. The extent of these changes and the probabilities for the future have been presented in detail in the addresses that have been given. There is no question in the minds of your committee that for some years to come both factors in the problems will be adverse to annuity gift funds. Longevity has increased among donors and is not likely to diminish; investment earnings have decreased to a serious degree, and no one dare foretell the date or extent of their restoration. Life insurance companies and savings banks have already taken cognizance of the change by a reduction in their annuity rates and interest on deposits. We have arrived at a point where net earnings of 4% are difficult to maintain, and anything beyond that rate is a cause for congratulation.

Under these circumstances, the Sub-committee on Annuities presents for your consideration a schedule of annuity rates which is more conservative than the schedules recommended at previous conferences, but which at the same time aims to make an annuity gift an attractive form of investment. Let me make it clear, perhaps needlessly, that any change in rates should apply only to future gifts. No contract now in force should, or could, be invalidated by the adoption of a lower scale.

The schedule submitted herewith is based on the Combined Annuity Table of Mortality (Female) with interest earnings at 4%, corrected for semi-annual payments, the first payment at the end of six months from the date of the gift.

The rates, through what may be inexactly described as the middle and early advanced years of life, are calculated to provide a residuum of seventy per cent. Annuity gifts covering the lives of children are not recommended. An exception may be made where it is the unmistakable intent of the donor to foster the missionary interest of the child by reminding him by means of an annuity payment of the existence of the missionary society and its unselfish character. In any such case the annuity rate should be very low, and the semblance of establishing a trust should be avoided.

The rates on the earlier mature lives beginning at age 35 are deemed safe and are also just in view of the cost of managing the gift over a probably long period of time and the uncertainty of returns during that period. So few gifts are received from persons in the earlier years that the volume of annuity gift business would not be appreciably affected by a low rate, while the safety of funds would be enhanced.

From 35 years of age the single-life rates increase by one-tenth of one per cent per year until the age at which the graded rate would merge with the rates calculated on the basis indicated above, which takes place at age 55. At age 80 the calculated and adjusted rates, namely 8%, coincide. It is proposed by the committee that 8% be the limiting rate. No higher rate for advanced years is proposed, owing to the infrequency of gifts made beyond 80 years of age and the danger to the reserves if the donors live to an unexpectedly late period. Moreover, a rate of 8% should be eminently satisfactory to persons who observe the fundamental purpose of an annuity gift, namely, the benefit to the donee. For two-life cases the rates upon two female lives would be used with the same limits as under the single-life schedule.

A schedule of two-life rates is also submitted. The rate for two lives, whether two males, two females or a male and a female, is the figure where the perpendicular line of the older life and the horizontal line of the younger life meet.

INVESTMENT OF FUNDS FOR THE SAFEGUARDING OF ANNUITIES

JOHN H. GROSS

*Treasurer, Board of Pensions of the Presbyterian Church in the
U. S. A.*

Annuity funds have come into being through generous gifts to religious, educational and charitable causes. It is expected that wherever possible these funds shall be invested to return an average net income of not less than 4% per annum. The organization which administers them is confronted with a problem which includes the preservation of principal, the maintenance of income, and an intelligent understanding of investment trends. The task has become increasingly difficult in these days of exceedingly low interest rates.

MANAGEMENT

Certain students of finance believe that in the case of every large fund investment control ought to be strictly within the offices of the organization. This would involve an investment manager. His title might be that of treasurer. There would be provided for him such investment information and counsel as would seem best within the limits of the fund. The members of the finance committee would work through him. Under such an arrangement there would be a management characterized by experience, with centralized responsibility (the importance of which can not be exaggerated), and with the necessary flexibility, for investment opportunities must be accepted when they present themselves. Assuredly no novice would be chosen for such a task.

QUALITY OF HOLDINGS

Normally the bulk of the list should consist of high-grade bonds. The need for the preservation of principal is recognized without discussion. It seems impossible to be certain that bonds which are high-grade today will continue to maintain that status. There appears to be an element of risk in every investment.

At times a fund should be held, theoretically at least, almost exclusively in short-term securities of the highest grade and in cash. But an attempt to do that brings to the fore the question of how to maintain income. From a practical viewpoint the average security is likely either to appreciate or to depreciate over a period of time. It is a great advantage to be able to buy on a favorable price basis and to sell finally at a higher price than was originally paid. They speak truly who say that a dollar of appreciation is worth as much as a dollar of income. The problem is a difficult one today because the best bonds are selling at a very much higher price level and on a lower income return basis than the average of recent years. It is probably no exaggeration to say that some of the very finest bonds may be in danger of selling within the next several years five or ten per cent lower than their present price. Even so, it may be necessary for many investors to disregard market fluctuations.

TYPES OF SECURITIES

Railroad Bonds. Senior railroad bonds of good roads are still in the prime investment class. They will continue to rate high in an investment way. Even now these senior bonds are still protected by traffic. Under improving business conditions the picture for the better second-grade railroad bonds would become vastly improved in a short time.

Utility Bonds. There is a fear concerning all utility securities today. However, underlying mortgage bonds of good operating utility companies appear to be secure. There are those who believe that such bonds ought to be bought rather than sold in this period of political agitation against privately owned utilities. On the other hand, the present picture is far from reassuring as to bonds of utility holding companies. Where they appear in lists they need to be scrutinized very carefully with a view to possible sale.

Industrial Bonds. Some of these are exceedingly high grade. It is questioned by many, however, as to whether industrial bonds ought to be purchased by institutions in as large percentage as other types. Certain great industrial corporations are affected as to volume of business and earnings in a major degree by a period of business stagnation.

Government and Municipal Bonds. Everyone agrees as to the quality of the best securities in this general class. Church and charitable corporations are unlikely to hold them in as large percentage as would be the case if they were subject to tax. Therefore it is not necessary that buyers for such funds join the scramble to secure tax-free securities at any price. Some of the best Government and municipal bonds are giving a return of considerably less than 3% per annum at present prices.

First Mortgages on Real Estate. Recent years seem to have shown clearly that it is difficult if not impossible to guarantee successfully real estate mortgages. In other words, the guaranteeing principle appears to have broken down utterly in the present major financial crisis.

Certain church and educational funds have a large percentage of investment assets placed in the field of unguaranteed real estate mortgages. These loans have been made for the most part on homes. An argument favoring them is that the rate of income return is relatively high on the basis of security. An objection to mortgages is that they are not readily marketable. Investments of this type are far from liquid. Present mortgage holdings may suffer by a lowering of interest rates.

Church boards involve themselves in a personal relationship problem by the purchase of first mortgage loans on homes. It is difficult for any man to feel kindly toward the organization through which he loses his home in days of adversity under foreclosure. One can feel hurt and outraged, even though unjustly so, with the result that his heart and mind is no longer open to the presentation of the Gospel of Christ.

THE PROBLEM OF STOCKS

Certain recognized students of investment problems now hold that a limited percentage of investment money belonging to church and educational funds may well be placed in the common stocks of great American corporations. They would advise such purchases, if at all, only in a time of business depression. Naturally they would restrict such purchases to stocks of high-grade corporations in strong financial condition, rendering worthwhile service. The purchase of stocks repre-

sents one way in which ownership of things may be acquired. Possibly stock purchases had best be made, if at all, chiefly in the industrial field and should be limited for the most part to the stocks of companies which have no bonded indebtedness. Conservatism would seem to require that at best only a modest percentage of a corporation's funds should be used in the purchase of equities.

PROTECTION THROUGH DIVERSIFICATION

Experience has proven the absolute necessity of dividing the funds of an institution not only between different securities but between different types of securities. It is utterly impossible to know in advance exactly what securities will do well and what securities are likely to suffer loss of investment merit. An example may be found in the present situation as regards the utilities and to some extent the rails. An institution which places all its funds in one type of security, as for instance first mortgages on real estate, is running not only unnecessary but extreme hazards. The claim seems to be well established that diversification is at the foundation of all successful investment. It is doubtful whether any one factor is more necessary in the placing of institutional funds than a faithful adherence to this principle of diversification.

FEDERAL TAXATION OF ANNUITIES ACCORDING TO THE LAW OF 1934

GILBERT DARLINGTON

Treasurer, American Bible Society

The Revenue Act of 1934 made certain changes with regard to the taxation of annuities. Section 22 (b) (2) reads:

"Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year) until the aggregate amount excluded from gross income under this title or prior income tax laws in respect of such annuity equals the aggregate premiums or consideration paid for such annuity."

This means that in the Federal Income Tax Return for 1934 and every taxable year beginning after January 1st, 1934, until the present law is changed, part or the whole of every annuity payment is to be entered either under gross income or as a capital gain. If the annuity was issued in 1933, then only the 3% of the consideration paid is included under gross income. If the annuity is an old annuity and all the principal has been received back, then the whole amount received is subject to taxation either under Item 11, "Other Income," in the Federal Income Tax Return, or under Item 30, "Amount of Capital Net Gain or Loss," as the Department may definitely rule. See letters of Treasury Department, p. 27, dated Sept. 18 and Dec. 22, 1934. In some rare cases the 3% tax and the tax on any amounts paid over and above the consideration given for the annuity may both apply for the year 1934, if, (1) after the 3% tax, (2) the last refund of principal takes place, and (3) there is any capital gain paid in addition.

ANNUITY AGREEMENTS

27

TREASURY DEPARTMENT
WASHINGTON

IT:E:RR
CNW

September 18, 1934.

Mr. Gilbert Darlington, Treasurer,
American Bible Society,
Bible House, Astor Place,
New York, New York.

Sir:

Reference is made to your letter dated September 10, 1934, making inquiry as to where on the return form taxable income consisting of annuity payments received during the year should be reported.

In reply you are advised that, although the return form for individuals (Form 1040) for the year 1934 has not been completed, the form when completed will contain instructions relative to reporting the income from such source. As far as can be determined at this time, however, it appears that the income from such source should be entered on line 11 as "Other Income," and not as gain from the sale of capital assets.

Respectfully,

CHAS. T. RUSSELL,
Deputy Commissioner.
By Chief of Section.

TREASURY DEPARTMENT
WASHINGTON

IT:E:RR
CNW

December 22, 1934.

Mr. Gilbert Darlington, Treasurer
American Bible Society
Bible House, Astor Place
New York, New York

Sir:

Reference is made to your letter dated December 7, 1934, making inquiry as to where or on what line income consisting of annuity payments should be reported on the return form for the year 1934.

In reply you are advised that, although the return form for the year 1934 will contain the necessary instructions in that respect when ready for distribution, so far as can be determined at this time it appears that the income from such source should be entered on line 11 as "Other Income," as was stated in Office Letter of September 18, 1934, a copy of which is enclosed. Should provision be made for reporting such income as a separate item, that will, of course, be shown by the return form. Unless a different requirement should be specified in that respect, the information return on Form 1099 should be executed as suggested in your letter.

Respectfully,

CHAS. T. RUSSELL,
Deputy Commissioner.
By L. K. SUNDERLIN,
Chief of Section.

The debate on this section of the Revenue Act of 1934 in the Senate was most interesting. The purpose of this section seems to be primarily to stop any leaks that might occur in the present Income Tax Laws. Certain of the Senators believed that it was possible for persons of great wealth to purchase annuities and so to escape from paying income taxes for the next ten or fifteen years when tax rates will probably be high. As the average annuity paid to each of the American Bible Society's annuitants is only about \$100 a person per year, it is evident that Congress was not particularly anxious to tax such annuitants. If, however, a man of 60 paid a commercial company \$1,000,000 for an annuity, he would receive about \$85,000 a year for 11.76 years before he would be subject to any income tax. During this period the Government might need the income more than it would if business should be substantially better in 1945. It was brought out in the debate that in purchasing such an annuity the amount paid by the annuitant was less than the probable benefits granted because the life insurance company expects to earn interest on the principal consideration paid to it. This income is very largely exempt from taxation and cannot at present be reached directly. No explanation was given in the discussion as to why the 3% rate was selected. However, in the above example the annuitant would receive his principal back in 11.76 years and his expectation of life is longer than this. Deducting the 3% tax a year would prolong the refund of principal in this case to 18.18 years. It was stated in the debate that in England all annuity payments are taxable and that there no tax-free refund of principal is allowed. As Congress was seeking new sources of revenue it was easy to persuade a majority of those present to adopt this 3% tax. Although some were in favor of giving exemption to small annuities, this opinion did not prevail, and the 3% tax now applies without any exceptions or exemptions.

THE REVENUE ACT OF 1934 AND ANNUITIES OF RELIGIOUS, EDUCATIONAL AND CHARITABLE CORPORATIONS

Everyone who purchases an annuity from a commercial life insurance company knows what it costs him for his annuity. Those who make gifts to religious, educational and charitable corporations on the annuity basis know that they are both (1) making a gift and (2) purchasing an annuity, but they do not know exactly how much each amounts to. This matter

was discussed in a paper on Taxation and Legislation presented at the Third Conference on Annuities at Atlantic City, November 17, 1930. Various rulings of the Treasury Department on the taxation aspects of this matter are given on Pages 71-80 of the report of that Conference published in Wise Public Giving Series, No. 34. A letter from the Treasury Department on January 5, 1929, and printed on Page 74, says:

"In reply, you are advised that the cash value or present worth of annuities such as are mentioned in the list furnished with your letter, should be determined in accordance with Table A in Article 13, page 20, of Estate Tax Regulations 70, using the uniform rate of 4% therein employed."

This ruling is confirmed for the new Revenue Act of 1934 in the following letter IT:E:RR CNW of August 25th, 1934, from Wright Matthews, Acting Commissioner of Internal Revenue:

TREASURY DEPARTMENT

WASHINGTON

Office of
Commissioner of Internal Revenue

August 25, 1934.

Address Reply to
Commissioner of Internal Revenue
and Refer to
IT:E:RR
CNW

Mr. Gilbert Darrington, Treasurer
American Bible Society
Bible House, Astor Place
New York, New York

Sir:

Reference is made to your letter dated May 14, 1934, relative to the percentage rate to be used in determining the cash value or present worth of annuity contracts issued by your organization.

In answer to a similar question as previous presented, it was held in office letter of January 5, 1929, that such cash value, or present worth, was to be determined in accordance with Table A in article 13, page 20, of Estate Tax Regulations 70, using the uniform rate of four per cent. The question is now presented apparently by reason of the provision in section 22(b) (2) of the Revenue Act of 1934 to the effect that amounts received as annuities are required to be included in gross income for the purpose of the income tax, except that there shall be excluded the excess of the amount received in the taxable year over an amount equal to three percent of the aggregate premiums or consideration paid until

the aggregate of the amounts so excluded equals the aggregate premiums or consideration paid for the annuity contract.

In reply you are advised that, although the amount of income taxable to the annuitant is limited to three per cent of the cost of the annuity contract until the aggregate of the amounts so excluded equals the cost, the cash value, or present worth, of the annuity at the time of issuing the contract should still be determined by using the rate of four per cent, as held in office letter of January 5, 1929. You are further advised that the difference between such cash value, or present worth, and the amount actually received by your society may, in the case of an individual, be deducted as a contribution or gift in the taxable year in which it is made, subject, of course, to the limitation on such deductions prescribed in section 23(o) of the Revenue Act of 1934.

The provisions of section 22(b) (2) of the Revenue Act of 1934 apply to taxable years beginning after December 31, 1933.

Respectfully,

(Signed) WRIGHT MATTHEWS,
Acting Commissioner.

It is therefore clear, from this letter, unless you wish to contest the section of the Revenue Act of 1934 dealing with annuities or this ruling of the Internal Revenue Department, that the cash value or present worth of the annuity at the time of issuing the contract is to be determined by the Estate Tax Tables. These tables, of course, are the Actuaries' or Combined Experience Tables with interest at 4%. They have been used for many years in estate tax determination, and can be found in Estate Tax Regulation No. 70 for a single-life with the annuity payable annually at the end of each year, or in Wolfe's "Inheritance Tax Calculations," published by Baker, Voorhis & Co., New York, in 1905,* for single lives and also for two lives jointly. Unfortunately not all of the ages are worked out in the joint life table and therefore it must be commuted. To figure out an annuity payable to three persons will involve quite a little expense, and an effort should certainly be made to discover in advance if the annuitant will have to pay a Federal income tax before attempting to determine the market value of his annuity. Both the table in "Estate Tax Regulation 70" and in Wolfe's "Inheritance Tax Calculations" are for the value of \$1.00 payable at the end of each year. To convert these tables to annual, quarterly or monthly payments, or annuity accrued to the date of death the following adjustments should be made:

*Out of print.

If paid semi-annually	add .25
If paid quarterly	add .375
If paid monthly	add .45833
If paid to date of death	add .50

The formula for finding the adjustment is $\frac{m-1}{2m}$ in which m represents the number of annuity payments made during the year. If semi-annual payments are made the formula would be $\frac{2-1}{2 \times 2} = \frac{1}{4}$ and $\frac{1}{4}$ of \$1 is .25. See Wolfe's "Inheritance Tax Calculations," page 44.

The formula for finding the value of an annuity on the joint and survivor plan for two lives is $a_{\overline{xy}} = a_x + a_y - a_{xy}$ in which $a_{\overline{xy}}$ represents the value of an annuity of \$1 per year for the life of both annuitants until the death of the survivor, a_x represents the value of an annuity of \$1 per year for the life of the first annuitant on the single life annuity plan, a_y represents the value of an annuity of \$1 per year for the life of the second annuitant on the single life annuity plan, and a_{xy} represents the value of an annuity of \$1 per year on the joint life annuity plan until the death of one of the two annuitants. See Wolfe's "Inheritance Tax Calculations," page 23.

Care should be taken in using either of the above mentioned tables when figuring a_x or a_y in a joint and survivor annuity to see that the value of a_{xy} is adjusted to correspond with the value of the table used for a_x and a_y .

In using these formulas it is well to consult a competent actuary or some one who is experienced in calculating values of annuities in order to fully understand the process and avoid making mistakes.

Let us take a concrete case of an average annuitant. Let us assume that the average annuitant is a woman of 63 who has paid \$1500 to the American Bible Society for an annuity of \$102 a year payable semi-annually. The value of \$1 payable

annually is 8.46412. As our Society pays the accrued annuity to date of death we add .50 making the base rate 8.96412. This gives a market value of \$914.34, the gift value being \$585.66. The 3% taxable income is \$27.43. Deducting \$27.43 from the annual annuity of \$102.00 gives \$74.57, the annual refund of principal. If the annuity was issued in December 1933, it would take 12.26 years to refund the principal. In the 13th year there would be, in my judgment, first the taxable income of \$27.43, a final principal refund of \$19.50, and a capital gain or income of \$55.07. You will note that under the new law it takes 12.26 years to refund the principal, whereas under the old law it took 8.47 years. On the other hand, the expectation of life of this annuitant on the tables used by the commercial life companies today would be 16.99 years.

While very few persons pay their income tax for any other period than the calendar year, if an annuitant has been accustomed to use some other year in filing his or her Federal income tax, then the 3% applies to the first income tax report filed for any year commencing after December 31, 1933, and commencing before January 1, 1935. Since the value of the annuity is determined by the age when it was purchased, the amount of the 3% tax will remain the same whether the year begins on January 1st or on some other day. Where annuitants have several annuities it may be necessary to analyze and total all of their annuities so that they can tell how much to enter as the 3% tax and how much to enter as "Other Income" or "Capital Gains." It is rumored that the new Federal Income Tax Report blank will have a special section in the instructions dealing with annuities. It is hoped that by the time the 1934 report blank comes out the following questions will be settled:

1. After an annuitant has received back his full principal does he enter any further payments in the Federal Income Tax Return under Item 11 in Form 1040 or Item 4 in Form 1040A, "Other Income," or is this entered under Item 30, "Amount of Capital Net Gains"? The annuitant will undoubtedly prefer

to make the entry where he pays the lesser tax, and the Treasury Department will prefer to have it entered where he pays the larger tax. It is difficult to estimate in commercial annuities which method would bring a greater revenue to the Treasury.

2. If an annuitant of 60 purchased an annuity from a commercial life company for \$1000 in October 1934 with annuity payable monthly, would the \$14.16 that he receives in November and December be wholly entered as taxable income? On a whole year basis he would report \$30 as taxable income and about \$55 as refund of principal. The law says that "amounts received . . . shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3% of the aggregate premiums or consideration paid for such annuity." It is evidently safest to include the whole \$14.16 that is received as taxable income. Repeated requests have been made to the Treasury Department to settle this, but up to the date of this conference no ruling has been obtained.

After the conference a letter was received from the Treasury Department which answers this question. A part of the letter reads as follows:

"The Revenue Act of 1934 permits the annuitant to recover tax-free the aggregate premiums or consideration paid for the annuity, but requires him to include in his annual return of income a portion of the annual payments in an amount equal to 3 per centum of such original cost of the annuity. The aggregate premiums or consideration paid, in the case of an annuity purchased prior to 1934, upon which such 3 per cent return is to be made, is the original consideration or premiums paid, not the net worth of the annuity to the annuitant as of the year of 1934. In the case of an annuity purchased during the year of 1934, which annuity is payable in two or more installments over each twelve-month period, such portion of each installment shall be included in gross income as is equal to 3 per cent of the aggregate premiums or consideration paid for such annuity, divided by the number of installments so payable."

The above interpretation of the Law agrees with the explanation in Regulations 86 Income Tax, Revenue Act of 1934 issued by the Treasury Department.

Article 22 (b) (2) -2 reads as follows:

"Annuities — If an annuity is payable in annual installments, there shall be included in gross income only such portion of the amounts received in any taxable year as is equal to 3 per cent of the aggregate premiums or consideration paid for such annuity, whether or not paid during such year. If an annuity is payable in two or more installments over each 12-month period, such portion of each installment shall be taxable as is equal to 3 per cent of the aggregate premiums or consideration paid for such annuity, whether or not paid during the taxable year, divided by the number of installments payable during such year. As soon as the aggregate of the amounts received and excluded from gross income equals the aggregate premiums or consideration paid for such annuity, the entire amount received thereafter in each taxable year must be included in gross income. The provisions of this article may be illustrated by the following examples:

Example (1): A bought in 1933, for \$50,000 consideration, a life annuity, payable in annual installments of \$5,000. For the calendar year 1934 he would be required to include in gross income \$1,500 of the \$5,000 received during that year (3 per cent of \$50,000), \$3,500 being exempt. If A should live long enough to receive as exempt \$50,000, then all amounts he receives thereafter under the annuity contract would be included in gross income.

Example (2) A bought an annuity on November 1, 1934, paying \$96,000 as consideration therefor. The annuity amounts to \$12,000 a year, payable in monthly installments of \$1,000, and on December 1, 1934, A received the first installment. A shall include in his gross income for the calendar year 1934 the sum of \$240, being 3 per cent of \$96,000 (the consideration paid), divided by 12 (the number of installments payable over a period of 12 months)."

3. Is the present law constitutional, or will it be tested in the Courts? The future alone can give the answer to this question.

If the above information is given to annuitants, they should be left free to protest the tax or the rulings given as they may deem best. Some may decide to refuse to pay, but most will be anxious to comply without delay if they know what is desired of them by the new Revenue Act of 1934.

INTERNAL REVENUE FORMS 1099 AND 1096

Under the Revenue Act of 1934, just as under the previous acts, it is necessary to report any distributions made for salaries, interest, rents, royalties, or other fixed or determinable income paid to any individual during the year, totaling \$1000 or more

if single, or \$2500 or more if married. In column five of Form 1099, "Foreign Items and Other Income," payments of taxable income of over \$1000 for a single person, or \$2500 to one that is married, should be reported. It is well, however, to cover all such returns with a letter stating that this amount is based upon calculations which the annuitant may not accept, and to leave the annuitant free to take the matter up with the Department directly, if he so desires. It is only fair to inform each annuitant as to the amount that you are returning on Form 1099 in order that he may determine in advance just what he wishes to do in making out his own income tax report.

A letter received from the Treasury Department since the conference reads as follows:

"Only the amount of annuity payments which constitutes taxable income should be considered in the preparation of the returns of information, form 1099. Such returns are required in the case of taxable income equalling or exceeding \$1,000.00 paid to a single person. If taxable income is paid to a married person and you are aware of the annuitant's marital status, no return need be made unless the taxable income equals or exceeds \$2,500.00."

The "taxable income" to be reported by the organization as having been paid to an annuitant is the entire amount of annuity paid during the year if the organization had paid back to the annuitant an amount equal to the "consideration paid" for the annuity as calculated by the Government tables. If the "consideration paid" had not been entirely returned to the annuitant, then only the amount is to be reported by the organization which the annuitant must include as a part of gross income in the income tax report. This makes it necessary for the organization to calculate the amount of "taxable income" in cases where that amount is \$1,000 or more if paid to a single person, and \$2,500 or more if paid to a married person.

OTHER TAXATION AND LEGISLATION AFFECTING ANNUITIES

This Conference is primarily a conference about rates. No attempt, therefore, has been made to mention changes in the

tax laws of various states. Probably the best policy is to refer your annuitant to his or her bank or to some local tax authority. As the laws in the states change, and as various county assessors use different methods to determine the taxable value of annuities, this plan appears to be the best under present conditions.

Let me, however, urge all those who are issuing annuities to make sure that when they issue an annuity they are not really doing something else. If the donor has in mind a living trust or a permanent trust fund, make sure that you do not use the word "annuity" in any way. To confuse annuities and living trusts or other financial arrangements may result in opening up various other additional problems of taxation and may result in decisions that will adversely affect your whole annuity program. By all means have a printed form of trust agreement which is to be used in every case where the donor does not wish an annuity.

