HISTORICAL FILE

Annuity Agreements of Charitable Organizations

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THE NEW INSURANCE LAW
OF NEW YORK STATE

FEDERAL AND STATE
TAXATION AND LEGISLATION
AND ANNUITY RATES

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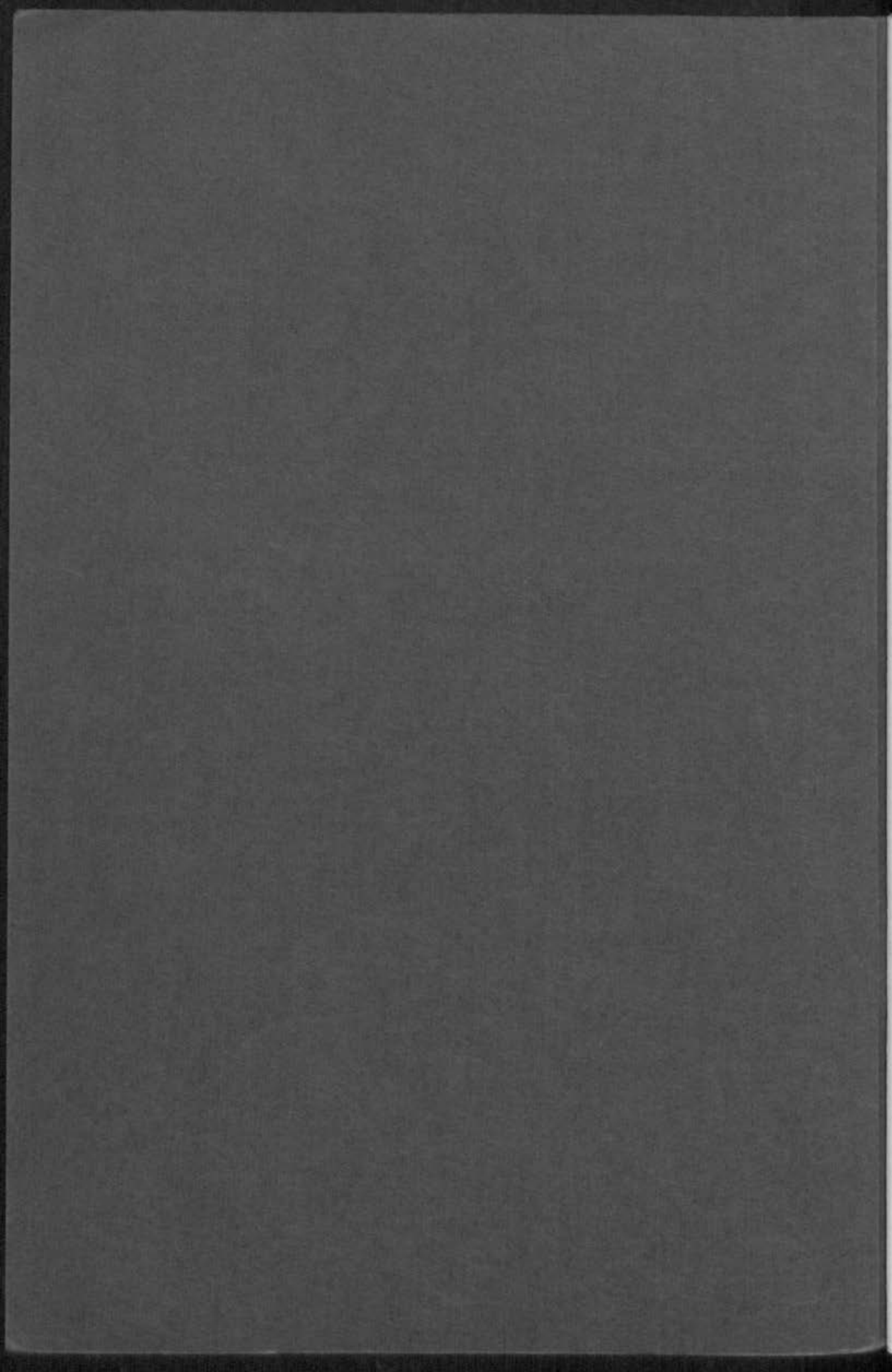
SIXTH CONFERENCE

WISE PUBLIC GIVING SERIES, NO. 44

1939



THE NEW INSURANCE LAW OF NEW YORK STATE

FEDERAL AND STATE TAXATION AND LEGISLATION AND ANNUITY RATES

PAPERS PRESENTED AT
A SIXTH CONFERENCE ON ANNUITIES, HELD IN NEW YORK CITY, OCTOBER 4-5, 1939, UNDER THE DIRECTION OF THE SUBCOMMITTEE 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

297 FOURTH AVENUE, NEW YORK, N.Y.

WISE PUBLIC GIVING SERIES No. 44

1939

CONFERENCE ON ANNUITIES

held under the direction of the Subcommittee on Annuities of the Committee on Financial and Fiduciary Matters of the Federal Council of the Churches of Christ in America.

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held under the direction of the

Subcommittee on Annuities of the Committee on Financial and Fiduciary Matters of the Federal Council of the Churches of Christ in America

FIRST CONFERENCE (*Wise Public Giving Series No. 18*) .... April 29, 1927

Actuarial Basis of Rates — Legislation and Taxation
Administrative Policy — Finding Prospective Donors
Securing the Gifts

SECOND CONFERENCE (*Wise Public Giving Series No. 31*) .... November 9, 1928

Legislation and Taxation — Annuity Rates and Reserves
Printing and Advertising — Accounting Methods
Investments

THIRD CONFERENCE (*Wise Public Giving Series No. 34*) .... November 17, 1930

Annuity Agreements: Cautions and Restrictions
Uniformity of Rates, Agreements, and Terminology
Reinsurance of Annuities
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Taxation and Legislation: Recent Developments
Administration and Investment of Annuity Funds

FOURTH CONFERENCE (*Wise Public Giving Series No. 38*) .... March 17, 1931

The Trend toward Uniformity — Legal Reserves
Uniform Rates — The Up-to-date Legal Situation

FIFTH CONFERENCE (*Wise Public Giving Series No. 43*) .... November 20, 1934

Investment of Funds for the Safeguarding of Annuities
Uniform Annuity Rates
The Mortality among Annuitant Lives
Federal Taxation of Annuities: Law of 1934

SIXTH CONFERENCE (*Wise Public Giving Series No. 44*) .... October 4-5, 1939

How to Obtain Annuity Gifts
The Regulation and Supervision of the Issuance of Annuity Agreements by a Charitable Society
Rates for Annuity Agreements
Outlook for Interest Rates
Securing Annuity Gifts
What Colleges and Universities Are Doing
Investment Planning under Revised Insurance Law of the State of New York
Taxation and Legislation Affecting Annuities

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FOREWORD

The sixth Conference on Annuities was held under the direction of the Subcommittee on Annuities of the Committee on Financial and Fiduciary Matters of the Federal Council of the Churches of Christ in America at the Pennsylvania Hotel, New York City, on October 4 and 5, 1939. The Conference was attended by 76 delegates, representing 17 denominations and 59 other religious, charitable, and educational institutions. Delegates attended from the following states: California, Illinois, Indiana, Maryland, Massachusetts, New Jersey, New York, Ohio, Pennsylvania, Tennessee, Virginia, and the District of Columbia.

The Conference was called for several reasons: First—because the new Insurance Law of New York State, Section 45, Article 4, requires a permit to carry on an annuity business in New York State after January 1, 1940, when this new law goes into effect. Secondly—the Conference was called to consider the question of current interest rates and current mortality experience. Since the fourth Conference held in November 1934 many of the life insurance companies have reduced annuity rates by about 14 percent. Thirdly—to consider taxation and legislation affecting annuities in the different states and by the Federal Government.

The program of the Conference consisted of the papers printed in this booklet in the order in which they were presented. The Conference by formal resolution expressed its thanks to those who had contributed in this and in other ways to make it a success. The Chairman was requested to inform the Treasury Department that, in the judgment of the Conference, it was desirable to increase substantially the 15 percent allowance for gifts from individuals, and the 5 percent allowance for gifts from corporations to religious, educational, and charitable corporations or associations in the proposed new Federal Income Tax Law.

While careful consideration was given to the annuity rates prepared by Mr. George A. Huggins, in view of the uncertainty of future interest rates due to war conditions and to the fact that several large denominations could not take final action on new rates until the early summer, it was

> "*Resolved*, That the Committee on Annuities be requested to publish in booklet form the papers read at this Conference by the several speakers; and also the proceedings of the Conference, including their decision to defer action on the matter of annuity rates, with the understanding that the Committee on Annuities call another Conference in the early spring of 1940, when and if it deemed it advisable."

Additional copies of this booklet and of the previous booklets "Wise Public Giving," Series *18, 31, 34, 38* and *43*, may be obtained as long as they are available for 50 cents each from The Federal Council of the Churches of Christ in America, 297 Fourth Avenue, New York, N. Y.

GILBERT DARLINGTON,
Chairman

HOW TO OBTAIN ANNUITY GIFTS

ROME A. BETTS
Associate Secretary, American Bible Society

In any program of promotion for an annuity plan, it is first of all essential to have a satisfied constituency. That is to say, a family of annuitants who have utmost confidence in the reliability and integrity of the organization to which they have entrusted their funds. There are several ways of developing this feeling.

First of all, if you have a house organ, make use of it on occasion to publish accounts of your annuity plan, endeavoring to incorporate from time to time testimonial letters that are particularly significant. Your house organ should also carry frequent advertising notices of your annuity plan with coupon attached, so that your constituency may be constantly reminded that the annuity plan is an onward moving department of your work.

Secondly, through the use of direct mail you can do much to build up good relationships. Occasional letters at Easter time or Christmastide without any reference to appeal—simply wishing them the greetings of the season, perhaps bringing them up to date on recent developments in the work of your organization—can be exceedingly helpful.

The point next to be considered is that of attractive printed material describing the plan. It is desirable to have at least one major booklet giving full details, and answering the questions that people are likely to ask when they are considering investing funds which may represent the savings of a lifetime. They must be assured of the safety and security of their funds. In addition to this important piece, there should be a variety of other material, which can be used as stuffers in various kinds of mailings, calling attention to the value of your annuity plan.

Having your own constituency well pleased is one thing. They will probably always remain the major source of your annuity business, but it is always necessary to keep adding new members to the family as old ones pass on. Some well-confirmed policy should be set up establishing a certain percentage of annuity income to be set aside for promotion. This amount should probably not exceed five percent of the total gross income.

The first obvious place to secure prospects is by advertising in the religious or other kind of press. Your own house organ, of course, should be used or your own denominational papers. In addition to that, there are certain interdenominational publications that have proved productive over a period of years. A certain percentage of your advertising budget should be set aside for experimental purposes to test out publications for new blood.

The second source of prospects is to request your own constituency to furnish you with names of prospects who might be interested in the plan. This should not be overdone, as it might cause annoyance. Then, too, there may be other logical contacts that you can make perhaps through your field secretaries, etc., to secure lists of prospects.

Once the inquiry has been secured, it is necessary to follow that inquiry up in a planned series of letters carefully spaced. Those letters should emphasize the security and safety of the plan; should be liberal in the quotation of testimonial comments, and should emphasize the fact that the gift will live after they move on, at the same time providing them with ample security during their lifetime.

This leads then to a comment regarding the content of advertising copy. Be careful to avoid copy which will play up the motive of fear. This is not only poor sportsmanship, but is probably inferior in pulling power to the motives of self-interest first, and altruism as a secondary consideration. The first thing to play up, it appears, is the feature of safety, security, and the knowledge that the annuitant will share in a world cause. Another salient point is the desirability of featuring, in advertising copy, personality rather than legal papers as the photographic or visual background of the ad. All annuity advertising should be illustrated,—visual,—in order to attract the eye; and those kinds of advertisements productive of the best result are those which feature people rather than documents.

In conclusion, it is most desirable to keep some kind of an accurate check on the successes and failures of your advertising copy, and of the letters which you use for follow-up and sales purposes, noting those which are good and those which are bad—discarding bad ones and building on the good ones. In regard to advertising, not only is it necessary to study the type of copy which is successful, but it is desirable further to know the media in which your advertising pulls, and the best times of the year in which to advertise. Taking the total of your advertising budget and dividing it by the number of inquiries you receive, you can tell from year to year how much it costs you to receive an inquiry. By doing this for the individual magazines, you can judge also which magazines are the most productive from the inquiry standpoint. Of course, you should bring into the picture the amount of business which results from these inquiries, because it is important to remember that, until an inquiry becomes a sale, it is only a liability, in that it costs money to follow it up.

THE REGULATION AND SUPERVISION OF THE ISSUANCE OF ANNUITY AGREEMENTS BY A CHARITABLE SOCIETY

CHARLES C. DUBUAR

Principal Actuary, Insurance Dept. of the State of New York

I am glad to have the opportunity of attending this meeting, and of discussing informally with you some of the aspects of the new insurance code in New York as affecting your annuity organizations.

As you know, an entirely new insurance code was enacted at the last session of the legislature. One of the reasons leading up to the revision of the old law was that modernization was needed. The law had not been recodified since 1909. Amendments had been added from time to time, with the result that the old law was antiquated and needed clarification in many instances. In order to secure expert outside advice in the revision, Professor Edwin Patterson, of the Columbia Law School, was engaged to act as chairman of the Committee on Revision. Working with the Joint Legislative Committee headed by Assemblyman Piper, and with the departmental staff, the task of writing the new code was finally accomplished this year.

So far as the regulatory provisions for charitable annuity corporations or associations are concerned, these are largely contained in section 45 of the new code. Section 45 is somewhat of an experiment. It is an attempt to surround the purchaser of gift annuities with the ordinary safeguards as to his money, to which he is entitled. The field of gift annuities is important, and is becoming increasingly so. On the other hand, it is also an attempt to avoid too much detailed supervision on the part of the Insurance Department, since I can assure you that this is neither desired nor sought. The kind of law which has been sought, is a law which is reduced to minimum essentials and which can be administered simply.

The success of the law, of course, depends upon the cooperation of the charitable annuity corporations, and, in a large measure, upon their own self-regulation of the field of gift annuities. Your meetings here today are illustrative of the type of self-regulation which is so beneficial to all of the parties at interest.

In so far as section 45 is concerned, I believe that your interest in this law may be threefold: First, what was in mind when the law was drawn; second, what are its specifications; and third, what is to be its interpretation

When the subject of regulating exempt annuity organizations was brought up for study, there seemed to be one difficulty under the old law: it gave perfect freedom to such organizations to operate, and the only condition was that they maintain adequate reserves. At the same time, the old law presumably placed upon the Insurance Department the responsibility to verify whether the reserves were or were not adequate. However, there were no easy means provided for making this verification. We did not know as to the names of the exempt organizations, nor their whereabouts; we received no reports, nor did we know as to the amount or character of the assets held. It was, therefore, felt that this could be corrected, if each annuity organization was required to make itself known by applying for a special license or permit. In order to safeguard the funds, certain other requirements were added. However, you will find that many of the formalities and regulations required of life companies were omitted. This was for the reason that the Department appreciated the purpose and character of the nonprofit corporations, and the fact that gift annuities were noncompetitive with those regularly sold by life insurance companies. I believe this may give the background leading up to the new section 45.

The second point, which I believe is of interest to you, is the specifications in the new law. You will find four principal requirements: adequacy of reserves; the rates shall be noncompetitive with those of life companies; the funds shall be segregated; and the investments shall be made in eligible securities. As regards the matter of reserves, an annuity organization must set up at least the same reserve as a life company. This means that the minimum reserve bases for new annuity contracts issued on and after January 1, 1940, will be the Combined Annuity Tables (set back one year) with 3½ percent interest. Less stringent minimum standards are required for annuity contracts issued during prior years. Depending upon the years of issue, these tables are McClintock's 4 percent table until January 1, 1931, and the Combined Annuity 4 percent table from January 1, 1931, to December 31, 1939. While these tables produce the technical reserves required under the law, there is the much larger question whether such reserves will prove adequate in actual experience, and whether it is not prudent for a charitable annuity corporation to retain the full principal of the annuity purchase money until the death of the annuitant. In other words, the original gift would be held intact without diminution. A number of corporations already follow this conservative procedure. It provides a cushion or leeway against the various contingencies which may occur. The annuitants may prove to be unusually long-lived, and there is a very good possibility of this. I might say that the annuity table now in use by the life companies for present

contracts is more stringent, to the extent of about 12 to 14 percent higher reserves, than the standard which I presume will be used by the annuity corporations.

Another contingency is that the interest earnings may not meet the rate at which the reserves must be accumulated. Further, there may be losses in investments, and what is very important, there must be provision for the future expenses of management. This cushion or leeway is nothing more or less than the providing of capital funds which every corporation needs. Once the capital funds are established, it enables expenses in current annuities to be paid out of current income.

The requirement that the annuity rates shall be noncompetitive with those of life companies, does not appear in these exact words in the law. What the statute does prescribe is that the rate of life income to be paid shall be so computed as to leave with the corporation upon the annuitant's death at least one half of the purchase money. Naturally, this results in a substantial reduction in the life income which could otherwise be paid, if there were no such requirement as to the fifty percent residue.

Theoretically, on the basis of such rates the corporation would, on the average, have a residue of 50 percent of the purchase price upon the death of the annuitant. However, actually this is a rather optimistic assumption. The factors which might prevent retaining 50 percent are problems which, I understand, will be discussed this afternoon and tomorrow, and deal with longevity of annuitants, interest rates, losses in investments, and expenses. Only recently I was informed that one large religious annuity organization, on its operations during the past twenty years, estimated its ultimate profits at only 15 percent of the aggregate purchase price, which is far different than a 50 percent residue. It is, therefore, highly desirable that a corporation should be realistic as to its ultimate profits. In the case of a small corporation with few annuitant risks, it is quite possible for all profits to disappear if annuitants are unusually long-lived, and a management of a small corporation might very well consider reinsuring or transferring its annuity risks to a life company.

The third specification in the new code is that the annuity funds must be segregated. I believe that the segregation contemplates three things: First, that the corporation shall bind itself through appropriate language in its charter, bylaws, or by resolution to provide and continue a segregation of the annuity funds, separate and apart from the other assets of the corporation. Second, that there shall be a trusteeship, with the title of ownership, of the annuity assets resting with the annuity department; and third, that the assets belonging to the annuity department shall be specifically designated and earmarked.

The necessity for these things, I believe, would be illustrated should, for instance, the corporation own an automobile which ran into and killed or injured a number of persons, with the result that judgments are filed against the corporation. It might then become most important as to whether the annuity assets were segregated and trusteed, and whether the annuity department had sole title to the annuity assets. A simple segregation, it seems to me, is not enough, since otherwise the corporation could use its annuity funds for other purposes, the only penalty under the law being the revocation of the special license or permit.

The fourth specification in the new code is that annuity funds must be invested generally in the type of securities permitted domestic life companies. A domestic life company may invest in U.S. Government bonds, the bonds of any state or the municipality of any state, corporate bonds, and preferred stocks which qualify under the earning tests stated in the law, mortgage loans up to two thirds of the value of the property, and real estate used solely for home office purposes. The law does not allow a domestic life company to purchase common stocks; nor does it permit the retention of real estate held other than for home office purposes beyond a period of five years from the date of its acquisition, except upon approval of the Superintendent of Insurance. The investment statutes are quite detailed and contain various other requirements and restrictions, and the foregoing is only a general summary.

Section 45 makes these exceptions to the foregoing: A foreign annuity corporation may invest in the type of securities permitted under the laws of the state in which it is incorporated to a life company domiciled there. A domestic annuity corporation may invest any portion of its surplus over and above the 10 percent minimum surplus required under the law in what may be termed as ineligible securities. Both a domestic and a foreign annuity corporation in every case will not be required to disturb their present investment portfolio during the next ten years.

The final point which I believe is of interest to you, is the interpretation to be placed upon the law. Of course, many questions will have to await decision until they arise. However, the matter of the procedure in securing a license or permit has been somewhat agreed upon. The corporation will be expected to complete an application form, and certify that it has met the various conditions in the law. I believe that most of you already have copies of this form before you.

I would like to stress that this is a tentative and not a final form, although it has been generally discussed with the department counsel. Briefly, it inquires as to the powers of the corporation, whether conducted without profit, whether engaged solely in bona fide charitable

activities, whether it has been in active operation for at least ten years. Question 6 of the application form inquires whether the present annuity rates are computed to provide a 50 percent residue on the Combined Annuity Table set back one year with interest at 3½ percent. Questions 8, 9, and 10 elicit information as to the segregation of funds; question 11 relates to investments; and question 12 is for the purpose of establishing whether a 10 percent surplus exists at the time of application. Page 3 of the form requires a certification to the previous answers by the principal officers. Page 4 requires the certification by the actuary that the annuity reserve has been correctly computed on the basis of the schedules submitted to him; while page 5 is a certification by the principal officers that the valuation schedules submitted to the actuary are complete.

I believe that the application form is as condensed as possible to establish the necessary facts for the issuance of a license or permit. The intent throughout of the law and of the application form is to safeguard the funds of annuitants. So long as this is done, I think you will find that once a permit has been issued, the requirements thereunder are generally simple and not burdensome in any way to reputable charitable organizations.

A Summary of the Discussion about the New Law

In order to secure a license to issue annuities in New York State after January 1, 1940, you should apply as soon as possible to the Superintendent of Insurance, Albany, New York, requesting him to forward to you the necessary application form and statements which must be filled in. The Insurance Department has stated that it will have these forms completed and available by December 1, 1939.

All New York corporations and associations should apply for a permit if they wish to continue issuing annuities. The corporations and associations of other states, if they have a representative or solicitor or make use of doctors in New York State, should also secure a permit. If, however, you are incorporated or organized in another state, and your dealing with residents of New York State is solely and entirely by mail, and there is no personal solicitation in any way, this may not be necessary.

Corporations or associations of other states than New York State may, however, apply for a permit if they wish to make annuity agreements in New York State, and should let the Insurance Department know as soon as possible of their desire to do so, in order that they may receive the proper forms to be filled in. Such foreign corporations or associations are allowed to invest in securities legal for domestic life companies in New York or in the kind of securities permitted by the laws of the state in which they were incorporated

or organized. They may also reinsure their annuities; but, in determining the reserves, the corporation or association will only be entitled to take credit, by way of deduction, for reserves on account of reinsurance ceded to life insurance companies authorized to do business in New York State. However, if the insurance company makes its contract directly with the annuitant, so that your annuity corporation acts only as an intermediary without any guaranty or liability on your part, then the Insurance Department has stated that no license would be necessary. Such foreign corporations or associations should also take up with the Insurance Department the form of resolution that should be passed by their board or governing body, in order formally to segregate annuity assets, and safeguard their annuity reserve in accordance with the laws of New York State. The form of resolution which is recommended by the Department is attached herewith (see page 15).

It will be permissible as regards annual reports to use a statement dated at the end of your last fiscal year, if you do not have a more recent statement available. The list of investments of the annuity reserve to be submitted, however, should represent the holdings at a date not earlier than November 30, 1939, in order that the Insurance Department may have an up-to-date picture of your investment portfolio.

If, for any reason, there is a delay in issuing your license, it is probable that the Insurance Department, in acknowledging your request for the application forms to secure a permit to issue annuities, will authorize you to continue issuing annuities until a suitable resolution can be passed by your Board and approved by the Insurance Department. When the permit or license is granted, it does not have to be renewed each year, but will continue during your compliance with the provisions of the insurance law of the State of New York.

If your corporation or association is a successor of one that was in business during the past ten years, you should bring this out fully by documentary proof, as otherwise you cannot comply with the provisions of the law about having been in existence for ten years before the permit is granted. If your corporation or association has had to take over or engage in a business venture, this does not change the nonprofit or benevolent nature of your work, if all the profits of the business are used solely to carry out the provisions of your constitution or charter, and if these profits do not inure to any stockholders.

After January 1, 1940, the minimum valuation standard in New York State for new annuities is the Combined Annuity Table with one year set-back in age, with interest at 3½ percent. While your reserves can be figured on McClintock's Tables at 4 percent for annuities written before January 1, 1931, and on the Combined Annuity

Table at 4 percent for annuities written from January 1, 1931, to December 31, 1939, it is suggested and urged by the Insurance Department that the computation of the total annuity reserve for all annuities be on the basis of the new standard. This will be accepted by the Insurance Department, because it will require more reserves than the earlier two tables. It will be easier to figure your reserves on the new New York standard rather than on three different standards; but, if you use the new standard, you will need more reserves and also more surplus, and this will be 10 percent of what you report for your reserves.

If your annuity assets are not segregated in a separate and distinct account, you should immediately make such a separation. While for ten years you may retain the present investments in your annuity reserves, all new investments after January 1, 1940, must be of the class of securities suitable for New York life insurance companies as of that date. However, foreign corporations or associations may make investments in the kind of securities referred to in the last paragraph on page 11. It will not be permissible to set aside certain securities for individual annuities after January 1, 1940, for the reason that all assets in which annuity reserves are invested must be held for all annuitants without preference or priority.

To protect your annuitants in case a judgment should ever be filed against your corporation or association, and in order to secure a permit to continue issuing annuities after January 1, 1940, it will be necessary for your board of managers or governing body to pass a resolution segregating the annuity assets as separate and distinct funds. The new law says:

> "and such assets shall be segregated as separate and distinct funds, independent of all other funds of such corporation or association, *and shall not be applied for the payment of the debts and obligations of the corporation or association or for any purpose other than the annuity benefits hereinbefore specified.*"

Conditioned on such an official action by your governing board, and the carrying out of the provisions of the same, a special permit to issue annuities will be granted when all the conditions of the law are complied with. The Insurance Department of New York State seeks to make sure by this formal action that these funds will be held exclusively for the purpose for which they were intended.

In order to find out the required reserves against your annuities, you must have an actuary or a trained accountant figure out these reserves on a basis of the table or tables mentioned above. If the assets in which your reserve funds are invested do not comply with

the standards of the insurance law of 1939 for new investments, you will have ten years in which you may remedy this.

All bonds having a fixed term and rate of interest which are not in default as to principal and interest, and which are rated in the five highest bond ratings published by recognized bond-rating organizations, may be reported at their amortized value instead of at their market values. Real estate obtained by foreclosure or otherwise should be sold within five years, unless the permission of the Insurance Department is given to retain it longer, or unless it is used as a head office for your annuity fund. Annuity funds may not be invested in head-office real estate except to the extent of the value of the property actually used for annuity purposes; but, in no event, may real estate property hereafter be acquired for this purpose except with the consent of the Superintendent of Insurance.

Inasmuch as many different forms of annuity agreements have been in use in the past, the application for a permit will require only copies of each of the forms that will be used after January 1, 1940. However, it is to be noted that the statute does not require the agreement to partake of the nature of a trust, and from your point of view it may not be desirable to make agreements which would create a trust fund.

The Insurance Department is not vitally interested in whether the gift part of the annuity is designated for a particular aspect of your work, provided the annuity agreement is not drawn in such form whereby the whole principal parted with by the annuitant is to be held as a fund separate from other annuity assets and designated for a special purpose. This, of course, would make it an individual trust fund, and would be contrary to the purpose of the statutes.

Form of Resolution Approved at a Special Meeting Held October 19, 1939

WHEREAS, Article IV, Section 45 of the Insurance Law of New York State passed June 1939 and known as Chapter 882 of the Laws of 1939, provides, among other things, in respect to the exemption of Charitable Annuity Societies from certain provisions of the Insurance Law of the State of New York, that every duly organized domestic or foreign nonstock corporation or association conducted without profit engaged solely in bona fide charitable, religious, missionary, educational or philanthropic activities, which shall have been in active operation for at least ten years prior to the application for a permit hereinafter mentioned, and which issues gift annuity agreements, shall segregate from its assets as separate and distinct funds, independent from all other funds of such corporation or association, an amount at least equal to the reserves and surplus as required therein on all gift annuity agreements, and shall not apply said assets for the payment of the debts and obligations of the corporation or association or for any purpose other than the annuity benefits therein specified; and,

WHEREAS this Section provides for the issuance of a special permit by the Superintendent of Insurance of the State of New York for the purposes therein mentioned,

Now, therefore, *Be it resolved,* That, in order to meet the aforesaid requirements of the law and for the purpose of obtaining a special permit from the Superintendent of Insurance of the State of New York to issue Gift Annuity Agreements in New York, there shall be set aside and maintained assets of the corporation (or association) as a separate and distinct fund independent of all other funds of the corporation (or association) in an amount at least equal to the reserves and surplus of ten percent of such reserves on all the corporation's (or association's) outstanding gift annuity agreements required by Subsection 2 of Section 45 of the Act, which shall be invested in securities permitted by the provisions of Subsection 2* of Section 45 of the Act, and which segregated funds shall not be applied for the payment of the debts and obligations of the corporation (or association) or for any purpose other than the annuity benefits herein referred to, and which fund shall be known as (by a name that will clearly designate it as the reserve account contemplated by this Section).

Any assets heretofore segregated and held as separate funds on account of annuity benefits shall be merged with the aforesaid segregated assets to the extent required, in order to comply with the provisions of Section 45.

* For foreign corporation or association add Subsections 2 and 3.

MAXIMUM ANNUITY INCOME POSSIBLE UNDER SECTION 45 OF THE NEW YORK INSURANCE LAW, EFFECTIVE JANUARY 1, 1940, PER $1,000 OF PURCHASE PRICE

Age Male	Age Female	*Maximum Single Life Annuity	Age Male	Age Female	*Maximum Single Life Annuity
21	25	40.10	57	61	58.84
22	26	40.28	58	62	60.06
23	27	40.47	59	63	61.37
24	28	40.66	60	64	62.76
25	29	40.87	61	65	64.24
26	30	41.09	62	66	65.81
27	31	41.32	63	67	67.49
28	32	41.57	64	68	69.28
29	33	41.83	65	69	71.18
30	34	42.10	66	70	73.22
31	35	42.39	67	71	75.40
32	36	42.69	68	72	77.73
33	37	43.02	69	73	80.22
34	38	43.36	70	74	82.90
35	39	43.71	71	75	85.76
36	40	44.09	72	76	88.84
37	41	44.49	73	77	92.15
38	42	44.90	74	78	95.71
39	43	45.34	75	79	99.55
40	44	45.80	76	80	103.68
41	45	46.28	77	81	108.14
42	46	46.79	78	82	112.95
43	47	47.33	79	83	118.16
44	48	47.89	80	84	123.80
45	49	48.48	81	85	129.92
46	50	49.11	82	86	136.55
47	51	49.77	83	87	143.76
48	52	50.47	84	88	151.61
49	53	51.20	85	89	160.16
50	54	51.98	86	90	169.49
51	55	52.80	87	91	179.68
52	56	53.66	88	92	190.83
53	57	54.58	89	93	203.08
54	58	55.55	90	94	216.52
55	59	56.58	91	95	231.30
56	60	57.68			

*The maximum annuity on a single life in each case is computed on the basis of the Combined Annuity Mortality Table with interest at 3½ percent (set back one year) to provide a residue on death of one half of the purchase price and with the first annuity payment at the end of the year.

RATES FOR ANNUITY AGREEMENTS

GEORGE A. HUGGINS
Actuary, Philadelphia, Pa.

At the Fifth Conference on Annuities held on November 20, 1934, as shown in the published proceedings of that conference, we considered quite fully the elements entering into the calculations of tabular annuity rates. Therefore, we need not devote our time to such a discussion today, except to summarize and say that, aside from any provision for expenses of administration related to the handling of gift annuities, the basic elements to be considered are (a) the rate of mortality, (b) the rate of interest earnings, and (c) the average residuum expected to be realized through the gifts.

Naturally, when calculating annuity rates, assumptions have to be made on these three points. In the matter of the first item, we can only adopt a standard table of mortality among annuitant lives adjusted as nearly as possible to the actual rate of mortality which may be reasonably expected among a group of gift annuity lives. The average rate of yield on the invested funds is one of the major subjects under the consideration of this conference. The average expected residuum adopted as a basis of rates by the previous conferences was 70 percent, and so we are proposing the continuance of this percentage.

As has been brought out in the discussions this morning, under the new regulatory legislation of New York there is a minimum basis of valuation for reserves, and a basis of calculating maximum permissible gift annuity rates.

During the few years which have elapsed since our last conference, there have been radical changes taking place in our economic life, and these have an important bearing on our consideration of annuity rates. The most far-reaching problem is due to the continually lowering rate of return on investments. Other speakers at this conference who are so well-qualified will give you an analysis of the present situation, and will give their opinions on the outlook for these interest rates. However, we are confronted by the fact that interest rates at the present time are far lower than they were five (5) years ago.

Furthermore, there has been continually increasing longevity among annuitant lives. This must be taken into consideration in calculating rates, in order that at the death of the annuitant there will be on hand whatever average residuum has been counted upon by the institution.

By residuum or residue, we refer to that portion of the gift which on the average the institution may expect to have remaining

at the time of death of its donor-annuitants or the surviving annuitants in the case of two-life agreements. If the institution so desires, a portion of the gift may be used immediately upon its receipt, but in such event sufficient reserves should be set aside, in order that the annuities may be paid in their entirety. If this is done, of course, the amount available at the time of the gift will not be as large as the amount which would be remaining at the time of the death of the donors or their beneficiaries, because interest could not be added.

In the set of schedules following, various comparative annuity rates are shown. In Schedule A there are shown annuity rates at quinquennial ages according to various bases of calculation. Let us look at this schedule for a moment. Column A shows the age at nearest birthday at the time the annuity agreement is entered upon. Column B shows the uniform maximum annuity rates which were adopted by the Fifth Conference on November 20, 1934. These rates have as a basis the Combined Annuity Mortality Table with interest at 4 percent. They are based on female lives and have been calculated to provide a 70 percent average residuum. However, there have been modifications made at the higher and lower ages. The modifications were made for several reasons. First of all, in the case of the younger ages, the gift funds may be administered for a number of years before the termination of the annuity life. A long period of administration may prove to be expensive. At the same time ultraconservatism must be used in calculating interest and mortality trends for such a long period; hence these rates were started at 3 percent. It was furthermore deemed best to put a limit of 8 percent as a maximum percentage to be paid to the older annuitants. The calculated tabular rates on this basis are shown in Column C.

Column D shows the effect of reducing the rate of interest used in the calculations from 4 percent to 3½ percent; while column E shows the effect of further reducing the interest rates to 3 percent, while maintaining the same table of mortality.

Columns F and G show the maximum annuity rates which can be granted to female and male lives respectively in accordance with the New York law. A one-year set-back in ages on entering the mortality table is prescribed. The maximum interest rate according to the New York law is 3½ percent, and the minimum residuum permitted is 50 percent of the original amount of the gift. The setting back of ages one or two years means entering the table at ages one or two years younger than the actual ages of the annuitant lives. This is a device to permit the use of a given standard mortality table, but at the same time make provision in advance for a slightly lower mortality experience than that of the standard table.

Columns H and I show the rates for female and male lives re-

spectively on the same mortality and interest bases as the New York law prescribes, only they have been calculated so as to provide a 70 percent residuum instead of the minimum 50 percent residuum of the law.

The one-year set-back in ages which is provided as a minimum valuation basis in the New York law is related to the general experience of insurance companies among annuitant lives. Various studies of mortality among gift annuitant lives which have been made in recent years show that this particular group of lives is a slightly longer-living group of lives even than the annuitant lives of insurance companies. There is a logical explanation of this difference. The class of people who make these annuity gifts is very select. Similar to other annuitant lives, they are undoubtedly in good health or they would not be interested in annuity agreements. This is what might be called a natural selection, which is made consciously or unconsciously. But, in addition to this particular type of selection, we have a group of people who, by virtue of the fact that they are charitably minded, are a class of people who undoubtedly live exemplary lives. They take care of themselves, lead a very wholesome existence, and are thrifty enough to have accumulated the money which they give away.

Because of all these factors, the Committee on Annuities has deemed it advisable to recommend to the Conference that, in making calculations of uniform rates for gift annuity agreements, the mortality basis should be the Combined Annuity Table with a set-back in ages of two (2) years instead of the one-year set-back prescribed by the New York law as a minimum basis. Accordingly, columns J and K have been inserted in Schedule A to show the rates which would be payable on the basis of the Combined Annuity Table with 3½ percent interest on male and female lives with a set-back in ages of two (2) years before entering the annuity table, and calculated to provide a 70 percent residuum.

There may be those present who feel that the Conference should adopt an interest rate of 3 percent instead of 3½ percent in calculating these annuity rates, and, therefore, columns L and M have been inserted to show what the rates would be if a 3 percent interest earning basis was used instead of a 3½ percent basis, as shown in columns J and K.

The last two columns, N and O, show the uniform annuity rates which are now being paid by many of the leading life insurance companies which are in the annuity business. These rates are, of course, calculated on the basis of absorbing the full amount of the consideration paid to the insurance company by the time the contracts have terminated. In other words, insurance companies, in calculating their

rates, naturally do not provide that any portion of the premium be a gift.

In the gift annuity business we are not competing with life insurance companies. If an individual regards these gift annuities purely from the commercial angle, then he would be far better off to go directly to an insurance company, where he would receive a larger return on the original amount of money. A gift annuity agreement should be issued only on the basis of being a charitable transaction, even though there is provided a reasonable guaranteed income to the donor during his or her lifetime, and in some cases during the lifetime of one or two other beneficiaries.

All the rates shown have been calculated to provide semiannual annuity payments to the annuitant ceasing with the last payment preceding death.

Now, let us turn to Schedule B. Schedule B shows a more complete set of annuity rates than those shown at specimen ages in certain columns of Schedule A. It will be noted that these rates are given at all ages at entry, from 30 up to and including 80. Column 1 shows the rates similar to those in column B of Schedule A; i.e., the present uniform annuity agreement rates adopted by the Fifth Conference on November 20, 1934.

Column 2 shows the proposed revised rates which are now submitted to this Conference by the Committee on Annuities similar to those shown in column J. They are based upon the Combined Annuity Table with 3½ percent interest, are calculated to provide a 70 percent residuum, and are applicable to both male and female lives, although they are female life rates set back two years, that is, two years younger than the actual ages. There is no modification in this schedule of tabular rates at either the higher or lower ages, but in column 3, there are shown these tabular rates modified at the higher and lower ages.

The modifications referred to are (a) at the higher ages, a limiting rate of 7 percent, and (b) at the younger ages, a limiting rate of 2½ percent up to and including age 35, with the limit increased thereafter by one tenth of one percent as the entry ages increase.

The Committee is of the opinion that these rates would be, under present conditions, a very conservative set of rates. They are ones which would give reasonable assurance that, upon the termination of the annuity agreements, there would be at least an average 70 percent residuum if the invested funds yield 3½ percent interest.

There is a serious consideration which must be kept in mind while considering which basis of annuity rates to use. Some of you may feel that we should adopt a 3 percent interest basis; but we must

remember that, although these annuity agreements should not be entered into in a commercial aspect, nevertheless there is undoubtedly a minimum point of annuity rate below which it would be difficult to obtain new gifts. It would not be advisable to reduce the annuity rates to such an extent, that our organizations would not be able to obtain any more annuity gifts, so that, while we want to be as conservative as possible, we do not want to be so conservative that we would feel the effects of the law of diminishing returns.

Schedule C has been made up for sample* ages, to show the annuity rates payable on two-life agreements; i.e., where the annuity to be paid to the donor and a beneficiary will be a joint-life and last-survivor annuity, and where the agreement will not be terminated until the death of the survivor of the two lives.

These rates are shown both according to the scale adopted at the Fifth Conference, and also according to the proposed scale; i.e., where the rates have been modified at the younger ages, and where calculations have been made according to the Combined Annuity Table with interest at 3½ percent, so that a 70 percent residuum will be provided, and where all lives have been considered as female lives with an age set-back of two (2) years.

With these various annuity rates before you, we trust that the Conference will be in a position to decide which basis will prove the most satisfactory to adopt for the rates to be used in the future.

NOTE: The Conference voted to defer action on the matter of a change in uniform annuity rates until the spring of 1940, by which time the effect of the developments of the winter would become more apparent. It was the expressed desire of the Conference that the Committee on Annuities hold another conference in the spring, unless in the judgment of the Committee such conference should become unnecessary. The rates prepared by the Committee are published in order that any one may study them or use them if they so desire.

COMPARISON OF ANNUITY RATES

SINGLE LIFE

SCHEDULE A

A	B	C	D	E	F	G	H	I	J	K	L	M	N	O
30	3.0%	4.3%	3.9%	3.4%	4.1%	4.2%	3.8%	3.9%	3.8%	3.9%	3.4%	3.4%	3.8%	4.1%
35	3.0	4.4	3.9	3.5	4.2	4.3	3.9	4.0	3.9	4.0	3.4	3.5	4.1	4.3
40	3.5	4.5	4.0	3.6	4.3	4.5	4.0	4.1	4.0	4.1	3.5	3.6	4.3	4.7
45	4.0	4.6	4.2	3.7	4.6	4.8	4.1	4.3	4.1	4.2	3.6	3.8	4.7	5.1
50	4.5	4.8	4.3	3.9	4.8	5.1	4.3	4.5	4.3	4.4	3.8	3.9	5.1	5.6
55	5.0	5.0	4.5	4.1	5.2	5.5	4.5	4.7	4.5	4.7	4.0	4.2	5.6	6.3
60	5.3	5.3	4.8	4.4	5.6	6.1	4.8	5.1	4.7	5.0	4.2	4.5	6.3	7.2
65	5.7	5.7	5.2	4.8	6.2	6.9	5.1	5.5	5.1	5.4	4.6	5.0	7.2	8.4
70	6.2	6.2	5.8	5.3	7.1	7.9	5.6	6.2	5.5	6.0	5.1	5.5	8.4	10.0
75	7.0	7.0	6.5	6.0	8.2	9.4	6.3	7.1	6.2	6.9	5.7	6.4	10.0	12.2
80	8.0	8.0	7.5	7.0	9.8	11.6	7.3	8.3	7.1	8.1	6.6	7.6	12.2	15.2

A — Age nearest birthday at date of annuity agreement.

B — Uniform rates adopted at Fifth Conference, November 30, 1934.

C — Combined Annuity Mortality Table, interest at 4%, 70% residuum, female.

D — C.A. 3½%, 70% residuum, female.

E — C.A. 3%, 70% residuum, female.

F — C.A. 3½%, 50% residuum, female, age set-back one year.

G — C.A. 3½%, 50% residuum, male, age set-back one year.

H — C.A. 3½%, 70% residuum, female, age set-back one year.

I — C.A. 3½%, 70% residuum, male, age set-back one year.

J — C.A. 3½%, 70% residuum, female, age set-back two years.

K — C.A. 3½%, 70% residuum, male, age set-back two years.

L — C.A. 3%, 70% residuum, female, age set-back two years.

M — C.A. 3%, 70% residuum, male, age set-back two years.

N — Uniform annuity rates of life insurance companies, female.

O — Uniform annuity rates of life insurance companies, male.

NOTE: Semiannual payments cease with last payment preceding date of death of annuitant life.

GIFT ANNUITY RATES

SINGLE LIFE

SCHEDULE B

Age at Entry	Present Rates (1)	Proposed Revised Rates Unmodified (2)	Proposed Revised Rates Modified (3)
30	3.0%	3.8%	2.5%
31	3.0	3.8	2.5
32	3.0	3.9	2.5
33	3.0	3.9	2.5
34	3.0	3.9	2.5
35	3.0	3.9	2.5
36	3.1	3.9	2.6
37	3.2	3.9	2.7
38	3.3	3.9	2.8
39	3.4	4.0	2.9
40	3.5	4.0	3.0
41	3.6	4.0	3.1
42	3.7	4.0	3.2
43	3.8	4.1	3.3
44	3.9	4.1	3.4
45	4.0	4.1	3.5
46	4.1	4.1	3.6
47	4.2	4.2	3.7
48	4.3	4.2	3.8
49	4.4	4.2	3.9
50	4.5	4.3	4.0
51	4.6	4.3	4.1
52	4.7	4.3	4.2
53	4.8	4.4	4.3
54	4.9	4.4	4.4
55	5.0	4.5	4.5
56	5.1%	4.5%	4.5%
57	5.1	4.5	4.5
58	5.2	4.6	4.6
59	5.2	4.7	4.7
60	5.3	4.7	4.7
61	5.4	4.8	4.8
62	5.4	4.8	4.8
63	5.5	4.9	4.9
64	5.6	5.0	5.0
65	5.7	5.1	5.1
66	5.8	5.1	5.1
67	5.9	5.2	5.2
68	6.0	5.3	5.3
69	6.1	5.4	5.4
70	6.2	5.5	5.5
71	6.3	5.6	5.6
72	6.5	5.8	5.8
73	6.6	5.9	5.9
74	6.8	6.0	6.0
75	7.0	6.2	6.2
76	7.1	6.3	6.3
77	7.3	6.5	6.5
78	7.5	6.7	6.7
79	7.8	6.9	6.9
80	8.0	7.1	7.0

BASIS: (1) Combined Annuity Mortality Table, interest at 4 percent, 70 percent residuum, female, with rates modified at younger and older ages.

(2) Combined Annuity Mortality Table, interest at 3½ percent, 70 percent residuum, female, age set-back two years.

(3) Combined Annuity Mortality Table, interest at 3½ percent, 70 percent residuum, female, age set-back two years, with rates modified at younger and older ages.

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GIFT ANNUITY RATES

TWO LIVES—JOINT AND SURVIVOR

SCHEDULE C

Age of Younger Life	Age of Older Life 80	75	70	65	60	55	50	45	40	35	30
PRESENT RATES (1)											
80	6.6%										
75	6.2	5.9%									
70	5.8	5.6	5.4%								
65	5.5	5.4	5.2	5.1%							
60	5.2	5.1	5.0	4.9	4.8%						
55	4.9	4.9	4.9	4.8	4.7	4.6%					
50	4.4	4.4	4.4	4.4	4.4	4.4	4.4%				
45	3.9	3.9	3.9	3.9	3.9	3.9	3.9	3.9%			
40	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4%		
35	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0%	
30	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0%
PROPOSED REVISED RATES MODIFIED (2)											
80	5.8%										
75	5.5	5.3%									
70	5.2	5.0	4.8%								
65	4.9	4.8	4.6	4.5%							
60	4.6	4.5	4.5	4.4	4.3%						
55	4.4	4.4	4.3	4.3	4.2	4.1%					
50	3.9	3.9	3.9	3.9	3.9	3.9	3.9%				
45	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4%			
40	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9%		
35	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5%	
30	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5%

BASIS: (1) Combined Annuity Mortality Table, interest at 4 percent, 70 percent residuum, female, with rates modified at younger ages.

(2) Combined Annuity Mortality Table, interest at 3½ percent, 70 percent residuum, female, age set-back two years.

GAH—9-30-39

THE OUTLOOK FOR INTEREST RATES

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It is a well-recognized fact that investment yields have been declining for several years. Bond yields reached a new all-time low this summer, and in spite of the recent advance (which has been quite moderate), yields are still so low, that a few years ago they would have been considered fantastic. A good idea of the effect of this trend upon the incomes of institutional investors may be derived from an examination of Chart I. This is based on the experience of twelve of the largest life insurance companies in the country. The investment problems which confront these institutions are also problems of all organizations which derive an important part of their revenues from investments.

Problems

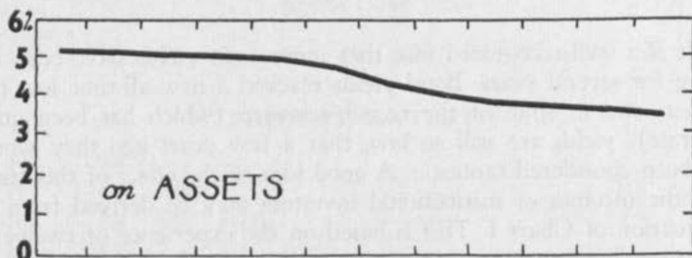
The rates paid to annuitants by organizations accepting gift annuities are calculated on the basis of several factors. One of these is an expected or assumed rate of return from investments. For a period of years this assumed rate has been 4 percent.

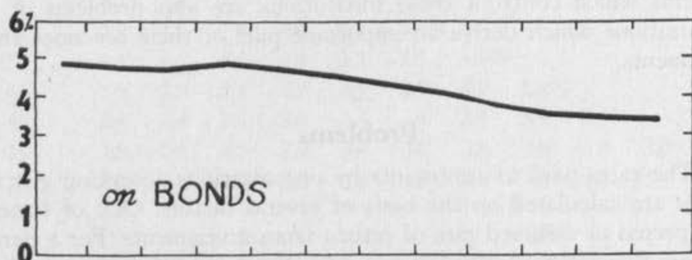
During the period in which this *assumed* 4 percent rate has been utilized, there has been a substantial decline in the *actual* rate available from investments. As the figures of the chart indicate, actual investment returns have declined in the order of 1 percent or 1.5 percent over the past ten years. One problem, then, is whether or not the assumed rate should be reduced, in order to bring it more in line with actuality.

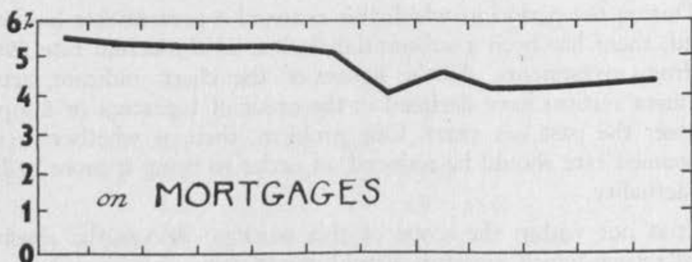
It is not within the scope of this work to discuss the absolute rate of return which investors should expect from any given types of investments. Each organization represented at the Conference doubtless has particular requirements as to income, and many of them are subject to certain limitations as to the type of securities in which they may invest. Another speaker at the Conference covered very ably the matter of investing under present conditions. This discussion is chiefly concerned with trends. What, then, is the likelihood that interest rates will continue at present low levels? If we are to understand the nature of this problem, we must first understand the factors which, in combination, have caused present conditions.

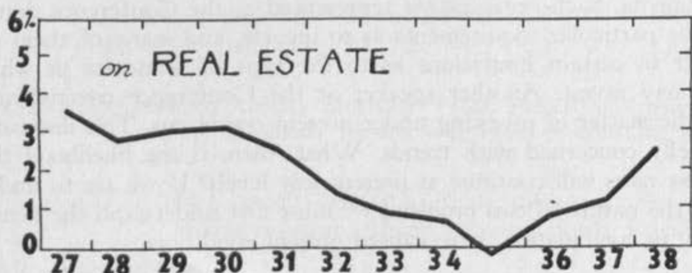
CHART I

RATES EARNED
by LIFE INSURANCE COMPANIES









Major Factors in the Decline of Interest Rates

In this section we shall deal chiefly with prices of high-grade bonds. The same factors which make high-grade bonds advance (and their yields decline) have, of course, exerted similar influences on the prices (or yields) of other high-grade fixed investments.

Prices of bonds, like those of any other commodities, are determined by variations in supply and demand. It is a well-known fact that the amount of investment funds held by banks, insurance companies, and other institutional investors is very large in relation to the supply of high-grade bonds. The rise in bond prices, and therefore the decline in interest rates on bonds, is directly attributable to this relationship. The supply of surplus investment funds among institutional investors has resulted less obviously but no less definitely from factors which have filled our banks to overflowing with surplus investment funds. One large bank in New York, with total assets of $2,300,000,000, holds cash alone of over $1,100,000,000. Another has 40 percent of its total assets in cash, and somewhat similar situations exist in practically every large city bank in the country. What has caused this tremendous accumulation of cash resources which is behind the demand for high-grade bonds? It is impossible to answer this question in detail in the space allotted to this discussion, but the major factors may be considered. There are two of these, and most of the important minor ones are related to or derived directly from them: (a) gold imports; (b) policy of the Federal Government.

Vast amounts of gold have been imported by this country in recent years. This gold has come, in most cases, to banks which have deposited it with the Federal reserve banks in their districts. The latter have turned the gold over to the Federal Government in exchange for notes, or depositary receipts. The important step, as far as this discussion is concerned, however, occurs when the banks receiving gold deposit it with the Federal reserve banks. Deposits of any member bank with a Federal reserve bank constitute the only legal reserve of such member bank. It makes no difference whether this deposit is acquired by sending gold to the reserve bank or by any other means. The point is that these reserves have increased tremendously in recent years, and the chief cause has been the import of gold.

The extent to which gold has entered this country, and its influence on bank reserves, may be seen upon examination of Charts II and III.

The reserves of member banks constitute the basis of their lending, or bond-buying, power. Broadly speaking, a bank can have $10 of deposits for every $1 of reserves. (The ratio may vary from time to time, but this statement refers to the basic principle rather than

Chart II

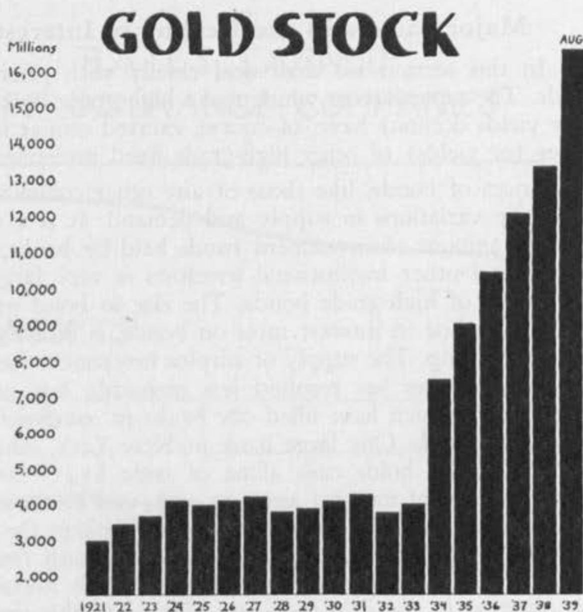
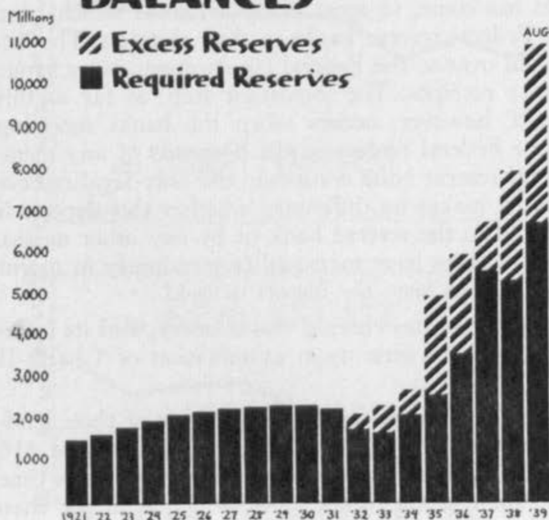


Chart III



to the current modification of it now in effect.) Bank deposits, except for the import of gold, arise chiefly from the purchase of bonds or of other investment media, such as commercial loans, by the banks. In effect, the banks acquire such investment media by the simple process of creating deposits in favor of the sellers.

It can be seen, therefore, that any increase in bank reserves must result in something like a tenfold increase in the power of banks to buy bonds or to lend money through other means. Chart II shows the tremendous increase in gold held in this country, while Chart III depicts the wide gains in reserves of member banks, resulting largely from the importation of gold. The crosshatched sections of the chart showing reserves denote "excess reserves." "Required reserves" are those necessitated by the regulations which provide that reserves must be approximately 10 percent of deposits. The "excess reserves" are those which represent the excess over the 10 percent requirement. Two aspects of these charts should be noted:

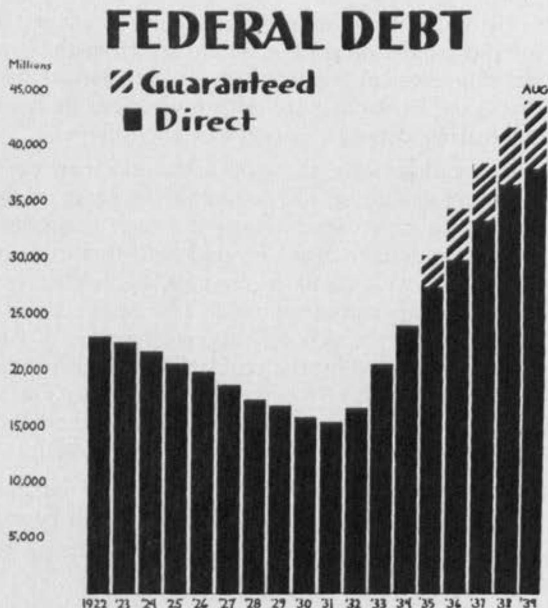
1. The required reserves are very large, indicating that bank deposits are at an unusually high figure.
2. Excess reserves *alone* are now far greater even than the total of *required* reserves in 1929.

The large size of these excess reserves indicates that the *banking system still has a tremendous amount of unused buying power.* This could be used either to purchase additional bonds or to make loans to industry, or for both purposes. The existence of large excess reserves has been a prime factor in increasing the demand for bonds and other investments, and in forcing their prices to high, and their yields to low, levels.

Let us now consider some of the effects of government policy. First of all, observe Chart IV showing the great increase in Federal indebtedness. This, at first glance, might lead to the conclusion that since the supply of government bonds has increased, the price ought to have gone down. However, as indicated in the discussion of gold, there has been a tremendous increase in the demand for bonds. This demand has been *actually* augmented to some extent, and *potentially* augmented to a far greater extent, by a Federal law which we shall discuss briefly.

Under the Hoover régime, in 1932, the Glass-Steagall Act was passed by Congress. This was an emergency measure designed to support the then collapsing bank structure. Under the present Administration this law has become permanent, or at least has remained "permanent" to date. Briefly, it provides that government bonds when held by the Federal reserve banks *acquire the same status as gold or gold notes* in the reserves of the reserve banks themselves. In effect,

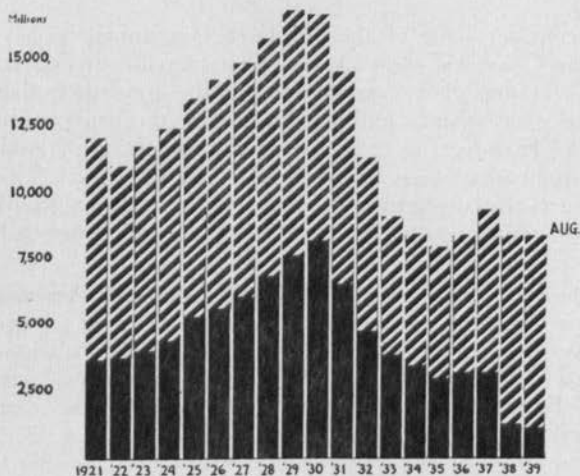
CHART IV



BANK LOANS

CHART V

"Other" Loans ■ Loans on Securities



this means that the reserve banks have almost unlimited power to buy government bonds. By buying government bonds, they enable member banks to purchase something like ten times as many of them, or of other investments, for their own accounts. The whole process has certain aspects in common with the "lifting oneself by one's own bootstraps" theory. Regardless of this, the law has been influential in increasing the demand factor, which in turn has influenced bond prices and interest rates. Should this country begin to lose some of its gold, the Government could restore reserve balances by putting government bonds in the reserve banks, and thus prevent a decline in reserves.

Let us next consider the supply side of the equation. While the supply of government bonds has increased, the supply of many other types of high-grade investments has diminished. Chart V, for example, shows the decline in commercial loans made by member banks since 1929. This is a direct result of "competition" by the Government with private banks. Various government agencies have loaned money to borrowers who, in many cases (although not in all), would normally have borrowed directly from the banks. In the mortgage field the Government has sought to induce expansion by accepting mortgages on easier terms and at lower rates than other mortgage-buying institutions have been willing to offer. Beyond this, there is no doubt but that Federal policy has, to an important extent, discouraged private enterprise, which would have produced a new supply of bonds and other securities available to investors.

Thus, in the final analysis, governmental policy has served on the one hand to increase the demand for investments, and on the other to reduce the supply or, at least, to prevent the supply from increasing in direct proportion to the demand.

The Future

We have seen that gold has been an important factor in increasing the demand for investments. Gold has come into this country, not only because our trade balance has been favorable, but also because other governments and their nationals have sent money here for safekeeping. Unless this country changes its policy governing the lending of funds abroad, it would appear that gold will tend to come to this country for some time. Furthermore, as a neutral or as a belligerent nation we should, for a considerable period, continue to have a favorable trade balance. Whatever happens abroad, it seems probable that foreigners will continue to leave their funds here for safekeeping. As far as we can see now, the prospects for any radical change in the trend of international gold movements is very slight.

As we have shown above, governmental policies have been im-

portant factors in raising bond prices and in reducing yields. The Government, as we have shown, is able to increase excess reserves at will, and so far its policies have been designed deliberately to create easy money. Because it must continue to borrow money for a considerable further period, regardless of war or peace, it seems to us this procedure will remain unchanged.

If the above factors could be considered alone, there would be no reason for expecting a rise in interest rates for some years. This is not the whole story, however. There are a number of potential developments which, over an indeterminate period, may cause a rise in interest rates. Among these are:

a. Financing by the Federal Government either for war purposes or for preparedness on such a scale, that the present credit machinery cannot stand the strain.

b. A business boom of such proportions that excess reserves are greatly reduced.

c. A serious postwar depression which would involve large-scale government financing, before the indebtedness acquired in the last depression has been paid off.

It is obviously impossible to predict when and whether or not any of these developments will take place. It can only be said that *most of the factors now operative are tending to maintain interest rates at low levels, and that these factors are likely to dominate the trend for some time. Ultimately, other factors will dominate, and a number of such potential factors have been mentioned. It does not seem, however, that there is sufficient likelihood that interest rates will advance enough in the near future to warrant reliance upon this as a basis for maintaining the 4 percent interest factor in annuity rates.*

Other Considerations

Even if interest rates rise over the next year or two, such an advance would have to be fairly rapid to offset the effect upon investment returns of maturity of high coupon bonds and refunding at lower coupon rates.

If business improvement on a broad scale develops during the next few years, institutional investors may have an opportunity to liquidate their weaker investments at more favorable prices than those now prevailing. If these are to be replaced by higher-grade investments, the result will be a decline in the average rate of return regardless of any other considerations. This is a most important point as regards individual policy, and one deserving of careful attention.

SECURING ANNUITY GIFTS

KENNETH W. MOORE

Treasurer, Board of Foreign Missions, Presbyterian Church, U.S.A.

In three types of annuities—religious, charitable, and educational—I believe, in view of the wide range of motives prompting giving in each field because of various objectives, that a number of kinds of annuities can be written. This also calls for various kinds of promotion.

In university annuities the motives of the donor may be that of love of alma mater, interest in the educational program of the university or in general education itself. The annuity rate on the investment, and the security of the fund also, should be carefully taken into consideration. To such a field an annuity with the memorial emphasis should appeal. But, let us not take time now to discuss these two types, but consider annuities written by religious organizations. What I say is from a personal viewpoint, and not that as representing any organization.

Two years ago, when I went in as treasurer of the Board of Foreign Missions, I found a strong annuity division, with a safe residuum, a wise annuity rate, which it has always in seventy-five years observed and never failed to pay. I felt compelled to study its history, to analyze its present status in the light of the past, in order to see where we are headed or where we should be headed in the future. Let me divide what I have to say into three parts, and part 3 into three sections. (Mr. Moore here presented complete analysis charts of the Foreign Board annuity set-up from 1926 to date.)

1. I believe, *all annuities must be established on an adequate financial foundation*. They must be safely secured, before new annuities can be secured.

Precedent to going out after gifts is the importance of being certain that the promise to annuitants can be fulfilled. Hence the need of an adequate reserve fund. Annuitants and prospective annuitants frequently and rightfully ask about the soundness of the annuities. Our Board lists its securities in its annuity fund separately from its other securities in its annual report of its treasurer. In every instance, the assurance given to annuitants should be definite, not some vague, nebulous general reply, such as, "This is one of the finest annuity investments in the world," "as good as gold," etc.

An annuity gift, by its nature, is an investment for the donor as well as a contribution to a society. It is a two-way contractual

agreement that must fully observe these two basic truths, always to be honored. This is very different from the special gift status, and must be treated accordingly.

2. I believe *adequate state laws to be necessary* to regulate the annuity business. I believe state laws should be enacted to protect annuitants, and I take this opportunity to command heartily the New York State Insurance Department for enacting the new law, effective January 1940, which has for its purpose the protection of all legitimate annuity business for the annuitants' financial interest. But, let us not get too many state and federal laws or we will be overburdened by forms and office work.

It is no secret that some religious societies and colleges defaulted in their annuity payments in the years of the depression, because they did not have adequate reserve funds. This is why I have stressed herewith these two ideas: (1) Adequate reserve funds; (2) adequate annuity laws. To secure new annuity gifts, what you have to sell or promote must first be secure.

Only in a comparatively few years, the annuity business has become big business. In its early years, it grew up like Topsy. Annuities to many societies have looked like easy money. Instead of by rule of thumb, it is now highly mechanical, technical, and scientific. Too little regard in the past as to what constitutes a solid foundation commensurate with such factors as types of annuity to be solicited, number of new annuities added each year, wise investing of the backlog, and many others in a field of more intense competition,—has brought some societies and colleges face to face with many serious problems.

It is all important that such organizations dealing in annuities be properly regulated and scrutinized by the State, as the insurance companies have been for some time.

To illustrate the need for this: A few years ago the Committee on Annuities sent out a survey questionnaire to religious, charitable, and educational organizations throughout the United States, to ascertain the extent of their annuity business and how they were conducting it. Certain of the questions related to the law in their state under which they were operating. A large number of the organizations replied. But, as for the questions about the law, many of them left them unanswered, which would seem to indicate that they did not know whether there was a specific law applying to their annuity business.

3. *I believe in religious organization annuities, provided* they are adequately promoted. After assurance of adequate reserve funds and adequate laws of protection, then the problem is adequate promotion to secure new gifts. Let me ask a few questions which I will try to answer, but with which you may or may not agree.

1. Why does a man or woman give an annuity to a church or church board? What is the motive?

I believe because that person has committed his life or her life to the will of God, and that the principal is very much in the nature of a gift of love to the Kingdom. The return often has significance and should be considered as part of the spiritual investment. In the case of elderly people, the return is often deeply appreciated and needed; but older people prefer to live more simply as they grow older. In the church field, the paramount stress should not be money. It kills, I believe, the very purpose for which an annuity in the religious field is intended, and takes away its sole right to exist. (Mr. Moore at this point gave examples of advertising which he contemplated issuing with the monetary appeal dominant, but, on careful study, he considered the idea of financial rates not to be paramount, but should be very definitely sublimated.)

For example, in the case of the largest living annuitant in our Board, the chief reason for his giving began as a seed when he was a child, was cultivated throughout the years in cumulative and increased interest and giving, and consummated at the age of eighty in a splendid gift of $367,933, because he believed that foreign missions brought God to the frontiers and within the reach of people who never had the chance to hear and learn of him. There he believed were the best returns on a spiritual investment in making Christ known. It was his gift of love for the work.

One day in a little country church, as a wee lad, he sat between his father and his mother listening to a Sunday evening talk by a missionary. When the collection was taken, his father placed a $5 bill in the plate. As he did so, the son gently laid his hand on his father's arm to restrain him, but his mother whispered, "Your father cannot afford it, but he believes in missions and wants to give. It's all right, don't worry about it." That night the seed of love for the Kingdom was sown in the heart of that small eleven-year-old boy, from which big acorns grew. Kill the seed of the love for God, planted at different ages, and you kill annuities.

2. Should a religious annuity be simple in form or offered in numerous variations?

Personally, a church or church board annuity, I believe, should be as simple as you can make it. An older person is not always so monetary minded, that he or she is solely looking for extra premiums, coupons or fine gifts. Just a simple contract as the law permits, to give a gift to the church on the simplest terms, and a clear idea as to what return is to be expected. This form of life annuity for one beneficiary or two beneficiaries, preferably one, I believe to be the best appeal.

Such a simple set-up simplifies your mechanics, your problems of estimation of taxation, etc., and enables one to avoid involvements in intricate combinations which complicate the problem.

Insurance companies today are offering many types of attractive insurance policies. They have to, for their competition is intense. Where a prospective annuitant can not be satisfied by one of our board annuities, there is no reason why it may not be possible for him to work out some combination insurance policy satisfactory to him and making the Board its beneficiary. We have policies of this character. Intricacies and difficulties can often be overcome in this area—the object, of course, being not to lose his gift to the Board.

The simpler the annuity, the simpler the contract, the simpler the method of securing new annuities, generally the sounder the set-up, everything considered. In our office, we believe in separating the outside work from the inside work. A man in the field must be posted on his subject fully, in contact with his headquarters, but not burdened with office details and mechanics. His task is to know who and where prospective annuitants are, and how to get them by personal interviews and judicious use of educational literature. He must feel called to the work, and that God has given him the task as his commission. This is vital to his success. It is also a wise policy to have a committee of reasonable size to give its assistance and direction. Then, too, it is advisable to have legal counsel and interpretation of the various tax problems. The laws are changing so rapidly in various states, as well as under Federal jurisdiction, that it is vital to keep constantly posted as to such changes.

3. What today should be a sound, adequate, attractive rate?

Call in your experts here and get all the facts, and you may have an answer. I recently studied the yield, etc., of all insurance companies in the United States for the last year and a few years previous. I am also studying pension rates and problems. One might say 3 percent is safe today as a base in the annuity field. Others might say lower.

But I am confident that we are right now at the *turn of the road*. I am frank to say, annuities do not look like as attractive a business today as they did not so long ago. The low yield on and shrinkage of investment, the increased competition, the dissolution of large estates, lower incomes, increasing and uncertain taxation, this year in particular war conditions, and the uncertainty of the future, the fluctuating value and purchasing power of the dollar, and international confusion are not favorable at present.

Passing over, for the moment, what the rate for this year should be, I would like to know why in church annuities the rate could not be simplified as follows—and I throw this out as a target. Face con-

ditions now! We must consider the problem from its immediate as well as its long range angles. I believe the standard base should be established and adjusted wisely from time to time when absolutely necessary. At the present time I would suggest a standard rate base, so that, on reaching 55, it could be scaled up to 65 when 6 percent would be allowed. Then from 65 on up, I would suggest maintaining the 6 percent rate. Rates below 55 to be given on application. We must always have an attractive rate appeal on all contracts with our annuities. It takes little to see that a 5 percent or 6 percent rate, practically guaranteed, is a wise investment today, over against the low yields of 3 percent and less, with such terrible losses in principal.

I would say, therefore, that the rate is our most serious problem which must be considered in this year of crisis. For, if it is not a reasonably sound rate, it may cause us all to reduce very materially our efforts to secure new annuities because of the greater risk, and compel us to seek special gifts, with less contractual strings, from individuals, in the religious field, who might be persuaded to erect to the memories of those they hold most dear, fitting memorials. Let the safety and security index be the answer; but let us not kill the goose that laid the golden egg by plucking too much of its original attractive plumage by destroying a worthwhile appeal.

WHAT THE COLLEGES AND UNIVERSITIES ARE DOING

J. HARVEY CAIN

Director, Financial Advisory Service, American Council on Education, Washington, D.C.

Mr. Darlington invited me to speak to you briefly on what the colleges are doing. Last spring we published a bulletin of 35 pages, which contains the views of the great majority of college business officers. During the past two weeks I have written to a small group of institutions in different sections of the country to learn the latest developments.

I think it can be truthfully said that the majority of large colleges and universities are not seeking annuities, and that about three fourths of the number of agreements that are in force were written and accepted by small colleges. This does not mean, however, that all the annuity funds are in the hands of small colleges. Nearly 70 percent of the total funds are held by institutions having $300,000 or more of endowment.

I shall now give a brief summary of some of the reports which I have received.

A privately controlled, nonsectarian college for women in New York State gives its rates as follows:

49 years and under	4	percent*
50 to 54 years	4	"
55 to 59	4¼	"
60 to 64	4½	"
65 to 69	5	"
70 to 74	5½	"
75 and over	6	"

Special rates on survivorship agreements.

This institution also stated:

> If our income were only 3½ percent and the annuitants performed according to the combined annuity table, there would be a residuum to the college of not less than 70 percent, whatever the annuitant's age might be.

A coeducational, privately controlled, nondenominational college in Ohio:

> Our contracts are based on a nominal rate of return, generally the exact amount earned on the investment.

* Actual earning if less than 4 percent.

A church-related college in Minnesota:

The highest rate is 5 percent, regardless of age. Contracts are based on cash gifts only.

A privately endowed, nondenominational university in southern California:

We have not accepted any annuities for the past ten years.

A church-related coeducational college in Ohio:

The following are our public figures for annuity gifts:

40-49 years of age	4 percent
50-59	5 "
60 years of age or over	6 "

From past experience, we have retained 60 percent of the principal.

A church-related college in Ohio:

We have adopted the schedule of rates shown on page 28 of the Financial Advisory Service Bulletin.

A church-related university in Illinois:

We are not interested in any annuity on a regular life insurance basis. Each prospect must be interested in doing something for education. No annuities are accepted on the basis of real estate. Only cash or liquid securities are accepted with a margin of at least 30 percent above what the same annuity would cost with a life insurance company, stripped of the usual carrying charges which are added by the company. For example, an annuity written on the basis of $250,000 could be purchased from a regular life insurance company for about $150,000. The balance of $100,000 would be treated as a gift to the university. The colleges of the country must discontinue annuities on the liberal scheme which so many have followed in the past.

A privately controlled, endowed university in Maryland, having funds amounting to $450,000:

No fixed formula for arriving at agreement. Each case receives individual consideration. Our experience has not been a very large one. At this time annuity payments are in excess of the amount earned and a considerable drain on the general funds of the university. I think annuity funds should be set up on a basis limiting annuities to the net return earned on the investment of the fund; or some provision should be made for charging any excess of annuity payments over income earned to the principal of the fund. We have added very few annuities in recent years.

Comment

1. I think the lack of a definite annuity program is very dangerous.

2. I think it would be preferable to draw upon the principal of the fund rather than upon institutional revenues. However, the principal should not be used for any other purposes until the termination of the obligation to pay the annuitant.

A church-related college in Ohio, total outstanding principal $500,000 written down to $250,000:

Our Board of Trustees has been very reluctant to accept annuities, and only one new gift has been accepted in the past five years, and this one from a previous benefactor. It is my own personal opinion that during the past two years there have been excellent opportunities to arrange annuity contracts at very low rates. Many people who could not find attractive investments would have been interested in annuities. Interest rates may go down still further, but institutions would be protected at the low rates which have prevailed. Old contracts have contained many mistakes, but with the figures that have been requested, I think it is possible to engage profitably in the annuity business.

A church-related university in Georgia:

We have accepted no new contracts in recent years. Present contracts amount to less than $3,000 per year, the rates being 4 percent, 5 percent, and 6 percent.

A large university in New York State:

We do not write annuities as such. We will agree to give any donor for his life, or that of other designated beneficiaries, such income, paid monthly, quarterly, semiannually or annually, as will be produced by the specific cash or securities he may turn over to the University. In other words, if such donor wants to use up principal, we recommend that he buy his annuity from an established insurance company that is in that business. If, however, he wants our Finance Committee to handle his gift, we will give all that can be earned therefrom, providing that at his death, and the deaths of any other beneficiaries he may designate, the capital sum is to become the property of the University.

A privately controlled university in Illinois:

The following principles and conditions shall apply to all gifts hereafter accepted which call for an unconditional undertaking by the University to make fixed payments during the lifetime of the donor or others named:

1. Such gifts shall be accepted only under conditions which will provide reasonable assurance (a) that no net loss will be sustained, and (b) that the University shall ultimately realize a substantial proportion of the capital sum for its educational purposes.

2. Such annuity contracts shall not be issued on lives under 50 years of age nor for joint annuities on more than two lives.

3. Gifts accepted subject to annuity payments shall not exceed the following principal amounts for any one life within the respective age brackets mentioned:

Ages	*Maximum Amount*
50-54	40,000
55-59	50,000
60-64	60,000
65-69	75,000
70-74	100,000
75-79	200,000
80 up	300,000

4. The rates or amounts payable shall be based upon: (a) An assumed life span for men of 85 years, and for women of 90 years, but with a minimum expectancy of ten years;

(b) A minimum required residue for the several age brackets as follows:

Ages	*Min. Req. Residue*
50-54	65 percent
55-59	60 "
60-64	55 "
65 up	50 "

(c) An assumed rate of return upon the investment of the fund which shall not exceed that currently available upon fixed return securities of investment quality and appropriate maturity.

From the above reports and from previous studies which have been made by me, I would like to enumerate the following important points:

1. Agreements should be drawn up with the utmost care by legal counsel familiar with actuarial and annuity practices.

2. The terms of the agreement should be fully explained to the donor.

3. The donor should be willing to make a substantial gift, and not expect the institution to compete with life insurance companies.

4. The annuity agreement should not restrict the institution as to types of investments.

5. Agreements should be based on a cash consideration. No agreements should be based on real estate.

6. Rates should be determined upon a long life expectancy. A minimum of ten years should be assumed at any given age. A discussion of rates is included in our bulletin. Some institutions assume that all annuitants will live to be 85 years of age, and one institution is now assuming that women will live to be 90 years of age.

7. The rate of interest is extremely important. It is better to have the contract based on the actual amount earned by the institution. Contracts for large amounts should be avoided for persons under seventy years of age.

8. Contracts should be based on an assumed residue of not less than 50 percent for persons over 65 years of age, and it is much wiser to figure on a residue of 70 percent for all ages.

9. No contracts should be written on more than two lives.

10. No contracts should be written on lives of persons under 50 years of age.

A college business officer sent me the following extracts from verses written about seventy-five years ago by a Scotch advocate, who

apparently considered that annuities, like Tennyson's "Brook," were likely to "go on forever":

The bargain looked fair enough—
  She had just turned sixty-three;
I could not have guessed she'd prove so tough
  By human ingenuity.
But years have come and years have gone,
And there she's yet as strong as steel.
The widow's growing young again
  Since she got her annuity.

I read the table drawn with care
  For an insurance company.
Her chance of life was stated there
  With perfect perspicuity.
But tables here or tables there,
She lived ten years beyond her share,
And is like to live a dozen more
  To collect on her annuity.

The Bible says the age of man
  Three score and ten perchance may be.
She's ninety-four—let them who can
  Explain the incongruity.
She should have lived before the Flood;
She came of patriarchal blood;
She's some old pagan mummified,
  Alive for her annuity.

INVESTMENT PLANNING UNDER REVISED INSURANCE LAW OF THE STATE OF NEW YORK

WILTON A. PIERCE

Chase Bank Investment Service

When it was first suggested that I prepare a paper to address this conference, I was somewhat conscious of my personal limitations, and I had barely started its preparation before I became well aware of the fact. While many years have been spent in investment planning for institutional and endowment funds, it has always been my privilege to exercise considerable latitude in suggesting securities suitable for the portfolio. Accordingly, if anything in this paper proves to be fact finding or of real assistance to this conference, full credit must be accorded to my associates at the bank, some good friends with the Metropolitan Life and other insurance companies, and, last but not least, your own library at Twenty-third Street.

You all know that the subject of annuities is one of wide ramifications, and it is not intended in this paper to discuss the legal aspects of the new law or annuities as a medium of charitable bequests. The new law, even as it relates to annuities, is voluminous, and to the layman, probably a rather burdensome statute difficult to digest. It seems appropriate, however, to say, in the first instance, that those well informed regarding the new legislation consider that it is a real accomplishment; that our State Superintendent of Insurance and his assistants, along with Assemblyman Piper and Edwin W. Paterson of Columbia University, deserve our sincere appreciation for the intensive work which has brought about this completed statute.

Any of the members of this conference now associated with organizations which continue to issue annuity agreements should regard the new law as an important phase in the future conduct of their investment planning. Admittedly, some of you will disapprove of the latitude permitted under the new investment powers. Some of you are probably agitated by these new provisions because of the new investment problems that will be brought before your finance committees. However, I feel confident that as your finance and investment committees start working under the provisions of the new law, its clarity in administrative procedure will be found welcome. True, it places additional responsibilities on the treasurer and his associated committees in the building up and maintenance of the portfolio. It will require much work on the part of your legal advisers to post the

treasurer on the ways and means of doing things under the new law. It is not within my province to discuss annuity reserves or the rates on annuity agreements to be issued by organizations represented at this conference. I do feel, however, all of you will agree that the new law will permit a greater latitude with respect to investment procedure, and will allow all portfolios to include acceptable commitments which, at least without the new legislation, would have been unacceptable.

I assume that, in the minds of most of you at this conference, is the amount or degree of latitude you should exercise with respect to these new investment privileges. That, of course, is not for me to dictate or even to advise, but, if my personal opinion is of interest, I would be inclined to suggest that you go all the way. It is not my thought that you should call on your investment dealer and request a tabulation of issues just within the minimum earnings ratios required by the new law. As a matter of fact, it would be better practice to begin at the far end of these requirements and, as we work down to the 1.50 earnings ratio, seek proper counsel and advice, in order to feel satisfied that any commitment showing, say, less than a two-times ratio, is really proper and acceptable for your fund. If this investment satisfaction is created, then some percentage of the fund could be invested in the seemingly somewhat lower grade issues. It would be difficult to apply any set percentage without specific knowledge of a fund's "Minimum Capital Investments" and "Required Reserve Investments"; but, speaking in a rather general sense, and considering the easy money policies that continue to exist, I would estimate that from 20 percent to 40 percent (a rather broad guess to be sure) might properly be invested in securities that range from a coverage of two to the border lines. This is a procedure that I feel all of us should willingly follow. Admittedly, if we want to avoid any responsibility, we can confine our investment suggestions to obligors like Norfolk & Western with an over-all coverage of better than ten times. I do not feel that it would be proper for me further to mention specific issues; but, to illustrate, I have in mind several well-secured obligations of important public-utility operating properties, where the earnings coverage is well within the requirements of the new law. In fact, the coverage is better than that of many other better known obligors which we would not hesitate to accept in a fund. Yet, I feel that the majority at this conference would immediately question the acceptance of the issues I have in mind, because the holding companies in control of these operating companies have been subject to severe criticism from both state and Federal agencies.

In other words, the operating companies I have in mind are undoubtedly acceptable as to statistical requirements, and only a reasonable amount of further judgment should convince us that their acceptability should not be ruled against merely because of the criticism attached to what is, after all, a "foster parent." This picture is probably a little far-fetched, but at least it does tend to illustrate the privileges that we now have, and that we should really exercise them to some degree. Since planned fiscal policies, planned economics and pegging of the prime security markets have become a seemingly chronic situation, it has been easy to conserve principal, our main objective, but without benefit of a "living wage" for the invested capital. All of us must realize that our duties are at all times at least twofold. You at this conference, with annuities outstanding and to be issued tomorrow and in years to come, must recognize that, while safety of principal is paramount, it is also merely the condition precedent. In other words, those methods of handling annuities are best which ensure the largest possible income with safety of principal. All avenues of approach should be carefully explored to satisfy your committees that they are agreeing to an investment program that is altogether fair to those whom I can best describe as "living beneficiaries." To accomplish this, your finance and investment committees should seek the advice of those skilled in the science of investment and fully alive to changes in economic, financial, and political conditions which might affect the value of securities. All of you must be conscious of the very great change that has come about in recent weeks because of the belligerency abroad. You probably will agree that the frightfulness of it all will have a very definite effect upon not only our psychology, but very definitely upon our own economy. The situation in industry and finance in this country will be complex. There are so many things to be considered, so many factors to be taken into account in presenting the goodness of any investment, whether it is a stock or a bond, that seeking sound advice in making investments seems absolutely essential to any finance committee attempting to safeguard the funds of the treasury or of restricted endowment funds.

TAXATION AND LEGISLATION AFFECTING ANNUITIES

GILBERT DARLINGTON
Treasurer, American Bible Society

The field of taxation and legislation of annuities in the United States is such a wide one, that it is almost impossible to keep up with its many ramifications. Conditions in the different States change from time to time, and even in various parts of the same state different methods of dealing with annuities are now in effect.

This article will not repeat the information which has already been given in previous Conferences on Annuities, but will try to give, in as condensed a space as possible, some of the more important matters affecting Federal and state taxation of annuities, grouped as follows.

I. Federal Taxes
- a. Income Tax
- b. Gift Tax
- c. Estate Tax

II. State Taxes
- a. Personal Property or Intangible Taxes
- b. Income Taxes
- c. Gift Taxes
- d. Estate or Inheritance Taxes

I. FEDERAL TAXES

a. Income Tax

If the annuitant's income is large enough, all annuities are subject to Federal taxation under the Federal Income Tax Law, as explained in previous papers on this subject. To summarize briefly: Under the Revenue Act of 1926, the annuitant is allowed a refund of the consideration paid for the annuity free from any taxation, until he has received back the full consideration paid, and after this the excess must be included in gross income. Let us call this the *old Federal Income Tax method*. The annuitant need not be the purchaser of the annuity in order to receive this exempt refund of principal.

However, as the result of a ruling, I.T. 2397, Internal Revenue Bulletin VII, 5-3591, p. 3, a contribution of $50,000 to a college was split into (1) a contribution to the college; (2) the "consideration paid"* for the annuity contract.

* Figured on the Estate Tax Tables.

This rule limited the tax exempt refund to the amount of the consideration paid for the annuity as determined by the Combined or Actuaries' Experience Table with interest at 5 percent, because this rate was mentioned in this particular annuity. Inquiry made at the Treasury Department resulted in the establishment of the Combined or Actuaries' Experience Table with interest at 4 percent, as shown in Table A, Article 13, p. 20, of the Estate Tax Regulation 70 for valuing all annuities in which no definite rate is mentioned. Copies of letters confirming this were given in Wise Public Giving Series No. 31, pages 9 and 10; No. 34, pages 71-80; and No. 43, pages 27-33. Let us call this then the *old Federal rule using the Estate Tax Tables.*

The Revenue Act of 1934, Section 22 b2, adopted a new rule, which we will call the 3 *percent rule.* This provided that 3 percent of the aggregate premium or "consideration paid"* as determined by the Estate Tax Tables at 4 percent should be included each year under "Gross Income," and the excess over this amount should be excluded from gross income and considered as the refund of the "consideration paid"* until the whole consideration has been returned to the annuitant. After this, the whole amount received as an annuity must be included as gross income under "Other Income" in the Federal Income Tax return. There was, however, some question as to what this 3 percent would be if only a fractional part of the whole annuity was paid in the first year. Internal Revenue Bulletin No. 41 of October 10, 1938, gives, under the ruling 1938-41-9572 I.T. 3223, the principle that, for a fractional part of a year, only a fractional part of the 3 percent of the consideration paid shall be reported. The 3 percent for a whole year is divided by 12—the number of months—and multiplied by the number of months the annuity was paid in the first year. See Treasury Decision 4857 (I.R.B. 1938-36,4). This is the 3 percent rule based upon the annuity being valued by the Estate Tax Tables at 4 percent, although the United States Board of Tax Appeals, Docket No. 86709, promulgated July 20, 1939, favored the use of the American Annuitants' Mortality Table in the following case.

Anna L. Raymond, a resident of Chicago, Illinois, born January 21, 1854, made nine gifts on the annuity basis totaling $1,246,906.76. If the Actuaries' or Combined Experience Table of Mortality used in Regulations 80, Article 10, for determining estate taxes was used, she had received back all of the principal value of her annuities. However, by adopting the price that commercial insurance companies would charge her for the same annuities, it was possible to show that she had received back the principal of only seven of the annuities. While additional income tax was due from her estate, it was very much less than it would have been had the Actuaries' or Combined Experience Table of Mortality been used. In fixing the gift value of

* Figured on the Estate Tax Tables.

these annuities, the Board accepted the American Annuitants' Mortality Table now in current use among life insurance companies in the United States as the standard of valuation. However, the Board of Tax Appeals does not have controlling power over the Treasury Department, which has decided, as per the following letter, to use the Actuaries' or Combined Experience Table of Mortality just as before.

TREASURY DEPARTMENT
Washington

September 11, 1939

Office of
Commissioner of Internal Revenue

The Federal Council of the Churches
of Christ in America, Inc.
297 Fourth Avenue
New York, N. Y.

Sirs:

Further reference is made to your letter of August 10, 1939, in which you refer to the decision of the United States Board of Tax Appeals in the case of Anna L. Raymond (Docket No. 86709, promulgated July 20, 1939), and state that such decision seems to establish a new method of determining "(1) consideration paid for an annuity; (2) the gift made to religious, educational, charitable, corporations issuing said annuities." You also refer to office letters dated January 5, 1929, August 25, 1934, and November 30, 1934, in which you were advised, among other things, relative to the use of Table A of the Estate Tax Regulations 70, which is based on the Actuaries' or Combined Experience Table of Mortality.

The bureau will continue to use the Actuaries' or Combined Experience Table of Mortality for Federal income tax purposes. Section 22(b) (2) of the Internal Revenue Code has not been amended.

It is believed that a copy of the American Annuitants' Mortality Table may be obtained from any insurance company.

Respectfully,

Timothy C. Mooney
Deputy Commissioner
(Signed) By L. K. Sunderlin
Chief of Section.

Federal Income Tax Returns from Source

Each year a copy of Treasury Department Form 1099 must be filled in for all annuitants who receive over $1,000 a year, if single, and $2,500, if married.

These returns are made up not from the total amount paid to each annuitant, but from the 3 percent of the "consideration paid"* for the annuity, which is included in gross income each year, plus the whole annuity paid after the annuitant has received back, tax free, the whole "consideration paid."* Also an affidavit must be executed on Treasury Form 1096, certifying that the reports on Form 1099 attached

* Figured on the Estate Tax Tables.

thereto are a true and complete return of all taxable income paid to the individual annuitants listed therein. These Forms must be filled in on or before March 15 of each year, and cover the preceding calendar year.

b. Federal Gift Tax

If "A" buys an annuity for "B" from a religious, educational or charitable corporation called "C", then (1) "A" is making a gift to the said charity which can be deducted for the current year in his Federal Income Tax up to the limits of 15 percent of his net income; (2) "A" is making a gift to "B" of the market value or present worth of the annuity as determined by the Federal Estate Tax Tables. These two gifts taken together equal the total amount parted with by "A." How is this to be reported under the Federal Gift Tax Law?

In the first place "A" is making a gift to "B," and this gift is determined by the method indicated above. If the annuity is payable immediately to "B," then "A" only needs to report the value of the gift, if it is over $5,000, for the years 1932-1938 inclusive, and over $4,000, for 1939 and thereafter until the law is changed. If the gift exceeds these annual exemptions, then "A" can apply the excess gift against his exemption of $40,000 if this has not been used up, and he must fill in Form 709 showing just how the gift is treated. Gift Tax Form No. 710 says that "The donee or trustee receiving such gifts is required to file this notice. If the gift is made in trust, the notice thereof should be filed by either the beneficiary of the trust or the trustee, but in such case one notice only is required. If the gift is not in trust, and the donee has died, his executor or administrator should file this notice." Should the religious, educational or charitable corporation "C" fill in Form 710? It is true that "C" has received a gift from "A," but this gift is a different gift from the amount that provides the annuity for "B"; and while "A" is required to report gifts to charitable and public corporations, in order that he may deduct them on Form 709, still there is no requirement that the charitable corporation or association must report the gift, unless it is of a "future interest in property." In the case of a single life annuity, no question of a future interest should come up.

However, if "A" purchases an annuity from "C" payable first to himself, and then to "B" after "A's" death, we have a different situation. "A" is making a gift to "C," but the immediate value of the annuity is applied to "A" and is therefore not a gift. Deducting the value of "A's" life interest from the total value of the annuity as determined by the Federal Estate Tax Tables, we get the value of the gift to "B" after "A's" death. Is this a gift of a future interest in property? The Treasury Department has indicated that it believes that

it is, but so far no one is known to have reported such a gift. We know that the annual exemption of $4,000 for 1939 does not apply to such gifts, and that they must be reported no matter how small they are. However, how can they be reported either on Form 709 which is for the donor, or on Form 710 which is for the donee or trustee. The donee "B" may not know either of the gift nor of the value of the gift. The insurance company or charitable corporation "C" may be unwilling to sign a *trustee's* report form for what is not a trust, but an annuity that may never be paid to "B" if he predeceases "A."

If the donor "A" reports the gift to "B" on Form 709, then the Internal Revenue Department may get in touch with "B," even though "A" does not wish "B" to know that he will some day receive an annuity. In such a case "C," the religious, educational or charitable corporation issuing the annuity, should warn the donor "A," that the Internal Revenue Department may check up with the donee "B" as to this gift, if it amounts to over $4,000 in value, or is a gift of a future interest in property, after the donor "A" has made a gift tax return on Form 709 concerning it. In such a case, "A" may request "C" to file a donee's or trustee's return in the hope of avoiding the embarrassment that may come to "A" if "B" learns of his interest in the annuity before it is planned that he should. It would be well, however, to indicate, if Form 710 is used, that "C" has received a gift from "A," and hence is a donee, but not a trustee; also that "A" does not wish "B" to know about the gift during "A's" lifetime. It is understood that some of the insurance companies only file such gift tax returns on Form 938 when requested to do so by the donor or by the Internal Revenue Department.

A gift of an annuity from "A" to "B" after "A's" death may not be "a gift of a future interest in property." If this is so, then the donor "A" is entitled to a deduction of $5,000 for the calendar year 1938, and $4,000 thereafter under the present Income Tax Law. If it should, however, be ruled that such an annuity is "a gift of a future interest in property," then every donor would probably have to report every gift he makes to another, of an annuity after his death, no matter how small. "'Future interests' is a legal term, and includes reversions, remainders, and other interests and estates whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time." It does not refer to "such contractual rights as exist in a *policy of life insurance, even if payable in the future.*" However, other forms of so-called annuities or trust agreements where the donor retains the right to change the annuitant, or the beneficiary, may be determined to be future interests in property. This question will probably soon be settled definitely.

c. Federal Estate Taxes on Annuities

Now that we have a carefully worked-out gift tax law, it should not be necessary to tax irrevocable annuities donated during the donor's lifetime as part of his estate when he is dead. Of course, if the donor retains the right to revoke the annuity or change the beneficiary, this will probably not be true; nor will it be so if a so-called annuity is really a Trust Fund or an "Annuity-Life Insurance Combination," that gives the donor or the beneficiary the right to a refund of the principal whenever either decides to take it.

Some persons are so old or in such ill health, that they cannot secure life insurance to make use of the $40,000 exemption of life insurance from the estate tax. An annuity-life insurance combination in a single policy, without medical examination, with 3 percent annuity and principal refund, appeared to some to solve this problem; but in 1932 the Supreme Court of Minnesota found such single-contract combinations to be subject to inheritance tax. In 1936 the Supreme Court of Oregon followed suit under the intangible income tax law; and in 1938 the Board of Tax Appeals in Old Colony Trust Company et al., Executors (Morss Will) 37 B.T.A. 435, CCH Dec. 9966, held that such a combination annuity and life insurance contract involved no element of insurance, and that therefore the $40,000 insurance exemption did not apply. This is the first Federal inheritance tax decision, and later the First Circuit in Old Colony Trust Company et al., Exrs. v. Com. 1939, 394 CCH ¶ 9358, 102 Feb (2d) 380, affirmed this. As the company took $42,000 from the decedent and agreed to return him $40,000 at any time plus 3½ percent interest in the meanwhile, the Court held this to be an investment contract and not life insurance. So also the Board of Tax Appeals treated an annuity-insurance combination in Chemical Bank and Trust Company et al., Executors (Saxe Will) 37 B.T.A. 535 CCH Dec. 9981, but where the insurance policy was separate from the annuity policy. Estate of Anna M. Keller, 39 B.T.A. ——, No. 153, CCH Dec. 10716 and Estate of Cecile Le Gierse, 39 B.T.A. ——, No. 160, CCH Dec. 10723, held that the separate single premium insurance policy which had a cash surrender value, was held to be insurance within the statutory exemption rather than a "transfer in contemplation of death." However, there was a strong dissenting opinion of five members in the Keller case, and it may be appealed.

On June 19, 1939, in the case of Estate of Sara E. Schultz, etc., Docket 94467 (CCH Dec. 10769-B), it was held that refund annuities where the beneficiary received the balance of principal not received by the decedent, were not insurance, and so must be included in the decedent's gross estate. Petition to review was dismissed.

However, the case of Harriot Reynold Schultz et al., executrices of the Estate of Marie B. Reynolds, deceased, v. Commissioner, 38 B.T.A. No. 10, Docket No. 81060, July 13, 1938, held that as the irrevocable annuity was bought before March 3, 1931, it was to be excluded from the decedent's estate, even though it could be revoked by the consent of all the beneficiaries, if there was "no legal restriction to the contrary." It also provided for a principal sum to the grandchildren of the decedent after her death and that of her daughter as well. Had the annuity been purchased after March 3, 1931, we can not tell if the decision would have been different. It refers to May v. Heiner 281 US 238 (74 L.Ed. 826, 50 S.Ct. 286, 67 ALR 1244, 8 AFTR 10904); McCormick v. Burnet; Morsman v. Burnet, and Hassett v. Welch.

Federal Estate Taxation of Irrevocable Trusts after March 3, 1931

In Wise Public Giving Series, No. 38, pp. 28-32, reference was made to three decisions of the Supreme Court on March 2, 1931, Nos. 535, 581, and 542. In each of these three decisions, the significant clause was added "there being no question of the constitutional authority of Congress to impose prospectively a tax with respect to transfers or trusts of the sort here involved." The very next day following these decisions, the Federal Estate Tax Laws were amended by Congress—under Subdivision (c) of Section 302 of the Revenue Act of 1926—to include in the gross estate thereafter "a transfer under which the transferor has retained for his life or any period not ending before his death (1) the possession or enjoyment of or the income from the property; or (2) the right to designate the persons who shall possess or enjoy the property or the income therefrom."

Court decisions since then appear to tax irrevocable trusts created after March 3, 1931, where the settlor retains a life interest in the income or in the enjoyment of the property. These decisions are stressed here, because many so-called annuities appear to be simply irrevocable trusts with a fixed income, or we might call them trusts in which the principal diminishes while the income is fixed. This is just another example of the great need of making an annuity agreement a simple and bona fide annuity without any trust terminology or connotations whatsoever.

II. STATE TAXATION OF ANNUITIES

As a general policy, it is best to refer the annuitant to his own bank or attorney with regard to the taxation of annuities in his own state. These tax problems are very complex, and are complicated by

the fact that property taxes and/or taxes on intangibles may be levied by a state that has an income tax law under which annuities are also taxable. It is, therefore, very dangerous to try to advise an annuitant on these matters. This is particularly so where different counties in the same state use different methods of computing or collecting the tax.

a. Personal Property or Intangible Taxes

The following states levy a property tax on intangibles:—Alabama,* Connecticut, District of Columbia, Florida, Georgia, Illinois,* Indiana, Iowa, Kentucky, Louisiana,* Maine,* Michigan, Minnesota, Mississippi,* Missouri,* Montana, New Jersey,* New Mexico,* North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, Tennessee, Texas,* Vermont, Virginia, West Virginia,* and Wyoming.*

States marked with an asterisk impose the tax on intangibles at the same rate as on other property, and probably most intangibles, therefore, escape taxation because taxpayers do not report them.

The following states deserve special mention:—CONNECTICUT has no tax on annuities; FLORIDA, no tax; ILLINOIS, the individual personal property tax return for Cook County provides for taxing annuities at their cash value on each April 1, debased 90 percent, and equalized by 37 percent. This procedure is complex and varies from one county to another. INDIANA used to tax annuities as personal property, but repealed this in 1933. Sections 4024 and 14073, subsection 26, exempt all annuities payable by religious, charitable, and educational institutions located within this state to any person who makes a gift to such institution. MAINE, no tax; MICHIGAN has a new law taxing annuities which goes into effect this fall. Regulations will probably soon be adopted by the State Tax Commission covering the form of return of this tax. NEBRASKA, no tax; NEVADA, no tax; NEW HAMPSHIRE, no tax; NEW JERSEY, no tax; OHIO, taxed as personal property at 4 percent of one half of the purchase price, if first payment is made after January 1, 1933. The state issues a 12-page booklet with tables covering taxation of five different varieties of annuities. PENNSYLVANIA, taxable as personal property. All counties, except Philadelphia, apply the four mills tax to the principal value of the annuity. In Philadelphia the tax is upon the amount of the annual annuity in excess of $200. RHODE ISLAND, no tax; TEXAS, annuities are valued under personal property tax "at the price that the person listing the same believes them to be worth in money."

b. State Income Taxes

ALABAMA has old Federal Income Tax rule; ARIZONA, old rule; ARKANSAS, old rule; CALIFORNIA, 3 percent Federal Income Tax rule

using Estate Tax Tables, but 3 percent to apply from beginning of annuity; COLORADO, 3 percent rule; DELAWARE, old rule; DISTRICT OF COLUMBIA, 3 percent rule; GEORGIA, 3 percent rule; IDAHO, old rule; INDIANA, old rule; IOWA, old rule; KANSAS, 3 percent rule; KENTUCKY, 3 percent rule or special excess value rule if preferred; LOUISIANA, old rule; MARYLAND, 3 percent or special excess value rule if preferred; MASSACHUSETTS, special tax of 1½ percent entered under Item 22; no tax if total income from all sources, taxable and nontaxable, does not exceed $1,000 if single, or $1,500 for both spouses if married; MINNESOTA, old rule; MISSISSIPPI, old rule; MISSOURI, old rule; MONTANA, old rule; NEW HAMPSHIRE, not taxable; NEW MEXICO, old rule; NEW YORK, 3 percent rule based on Federal Estate Tax Tables; NORTH CAROLINA, includes 3 percent as gross income yearly. This is not quite the same as the Federal 3 percent rule; NORTH DAKOTA, old rule; OKLAHOMA, 3 percent rule; OREGON, old rule; SOUTH CAROLINA, old rule; SOUTH DAKOTA, old rule; TENNESSEE, not taxable; UTAH, old rule; VERMONT, excludes from gross income all but 3 percent of the value of the annuity. This is taxable at the rate of 4 percent; VIRGINIA, old rule; WEST VIRGINIA, old rule; WISCONSIN, old rule.

State Income Tax Reports

More and more of the states each year are following the Federal Government in requiring that amounts paid to residents of the state be reported on special forms. While in some states it is not always clear whether salaries only, or also annuities and other sources of income are to be reported, it is believed that the following list of states may require a report of annuities paid to any individual over the limits given, and that these should be filled in each year. For the two states that require that everything be reported, it may be possible to agree on a limit of about $10 below which no report would be made. It is understood that life insurance companies and others are reporting annuities paid in these thirty states, with the possible exception of Minnesota.

However, whether these reports should be made by religious, educational, and charitable corporations on amounts paid to their annuitants is something that can not be definitely answered in each case.

State	*Amounts over If Single*	*Head of Family*
Alabama	$500	
Arizona	300	
Arkansas	1,000	
California	1,000	
Colorado	50	

Delaware	100	
Georgia	1,000	
Idaho	700	$1,500
Indiana	1,000	
Iowa	1,000	
Kansas	750	
Kentucky	600	
Louisiana	1,000	
Maryland	1,000	
Massachusetts	Everything	
Minnesota	On salaries only	
Mississippi	100	
Missouri	1,000	2,000
Montana	300	
New York	1,000	2,500
North Carolina	1,000	2,000
North Dakota	500	
Oklahoma	850	
Oregon	250	
South Carolina	1,000	
South Dakota	600	1,000
Utah	400	
Vermont	Everything	
Virginia	1,000	2,000
West Virginia	1,000	2,000

All of these states supply the necessary report forms, but sometimes the forms and the law do not agree.

In North Carolina two forms are used, one for the income tax, and the other for the personal property tax. When the annuity is first issued, if the annuitant can surrender the annuity, then it may be necessary to report the cash value of the contract on the last day of the calendar year on a report form prescribed by the state, but the state does not supply copies of this form.

All insurance companies "doing business" in the state of Ohio are required to submit a report each year covering annuities owned by residents of Ohio. Insurance Tax Forms 939-E are filled in by the issuer of the annuity for each new annuitant as of January 1 each year The Department of Taxation of the State of Ohio believes that the tax on annuities would be decreased if they had this information from charitable corporations, even if they do not do business in Ohio, but receive annuity gifts by mail only; for they believe the taxpayers may list the annuities in a way that is less favorable to themselves. This would be true if the annuitant listed his annuity on the 5 percent basis rather than on the 4 percent of one half of the principal amount. Up to now, however, the state of Ohio does not deduct the value of the outright gift to the charitable corporation from the total amount paid for the annuity. This results in many cases in a relatively higher tax on charitable annuities than on commercial annuities.

c. Gift Taxes of the States

Eight states now have gift tax laws effectual on the following dates:

State	Date	*Gifts to charity*
Oregon	June 9, 1933	Gifts to charity entirely exempt.
Wisconsin	July 8, 1933	Exempt to local, municipal or charitable corporations for use within the state.
Virginia	June 19, 1934	Entirely exempt for use in the state.
Minnesota	July 16, 1937	Exempt if operated within the state.
Colorado	Aug. 4, 1937	Exempt for use in the state.
Tennessee	Mar. 7, 1939	Entirely exempt.
North Carolina	Mar. 24, 1939	Exempt to corporations of another state which levies no gift tax on gifts to North Carolina charitable corporations, or for use in North Carolina.
California	June 21, 1939	has four reasons for exemptions: (1) If limited for use in Calif. (2) If organized under laws of Calif. or the United States. (3) Or a jurisdiction providing reciprocal exemption. (4) Or not imposing a gift tax on California charities.

Unlike the Federal Gift Tax, all of these states, except Oregon, limit the amount of the specific exemption to different classes of relatives and to others who are not related.

For Wisconsin only $1,000 can be transferred to any one donee in a year, and there is no additional exemption to a brother, or a sister, or their descendants, or to a son-in-law, or a daughter-in-law, or to an uncle or an aunt, or to any who are not related.

In California, the personal exemption to a brother, or a sister, or their descendants, and to a son-in-law or a daughter-in-law, is $2,000; but, in addition, there is a $4,000 exemption in any calendar year if the gift is not a transfer-in-trust or of a future interest in property. If the amount given is over $4,000 in any year and the $2,000 personal exemption is used up, then the rate of tax is 5 percent for the first $25,000, and 7 percent for the next $25,000, running up to 15 percent when over $500,000.

Just what is a gift of a future interest? In California there does not appear to be any annual exemption each year for this, and the

tax for gifts to friends, after a personal exemption of only $50, begins at 7 percent for the first $25,000, and 10 percent for the next $25,000. The annual exemption of $4,000 does not apply to a transfer-in-trust or a transfer of a future interest in property.

With regard to gifts to religious, educational or charitable corporations, we have listed above the action of the different states. It is easy to see how many new problems are raised by these gift tax laws of the eight states above listed. No one can tell how many more states will take similar action.

d. Estate or Inheritance Taxes

One of the most important recent decisions is in connection with the Estate of Frederick K. Day, who was a resident of New Jersey. Mr. Day purchased twenty-eight so-called annuities, aggregating a total of $196,000. Only eight of these annuities were held to be non-taxable, the others being taxable in one way or another. The State Tax Commission determined that all of the twenty-eight transfers were intended to take effect in possession or enjoyment at or after the death of the decedent, and therefore held them to be subject to tax. The Prerogative Court of the State of New Jersey, on appeal, considered that the first eight belonging and issued by the American Bible Society (3), American Tract Society (1), Board of National Missions of the Presbyterian Church (1), Philadelphia School of the Bible (1), Stony Brook Assembly, Inc. (2), were not taxable, as they "took effect and were intended to take effect in possession or enjoyment before decedent's death," whereas the other twenty were taxable. However, it was ruled as to the twenty that only the actual financial value received by the decedent should be included in his estate, and not the whole value of the transfer.

The eight exempt agreements made no mention of "interest" on or "income" from the sums given by the donor. They were simply promises to pay a fixed yearly sum. Neither did they contain any provision in any wise suspending or delaying the immediate transfer of full and unconditional beneficial ownership of the sums given. These transfers were held to be not taxable under the Honeyman Case. All of the other agreements were held taxable: (two) because the annual payments which were at the rate of six (6) percent per annum were designated as being "interest on the principal." Although there was no provision otherwise suspending or delaying the transfer of full ownership, they were taxable under the Harvey Case. Thirteen of the agreements, while not using the words "interest or income," provided that the sums given were "absolute gifts subject only to the agreement hereinafter expressed," or words of like effect. The gift, therefore, did not become completely operative until the agreement

to pay the annuity had been performed, which would be at the donor's death; until that time the effectiveness of the gift was subject to, and conditioned upon, the payment of the life annuity and remained incomplete. These were taxable under the Harvey Case. Two provided that the gift is not to be devoted to the general uses and purposes of the donee "until maturity." Three referred to the annual payments as being "interest" or "income on the principal" of the gift. The conclusions of the New Jersey Prerogative Court were affirmed by the Supreme Court of New Jersey, and finally by the Court of Errors and Appeals, which is the highest court of the state. See also the decision in the Estate of Laura H. Ellis.

In the state of Pennsylvania the result has been quite the reverse. In No. 76, January Term 1937, the Supreme Court of Pennsylvania, Eastern District, decided that two annuity bonds were taxable, the one in the sum of $35,000 dated March 30, 1929, and the other in the sum of $5,000 dated September 30, 1932. These were purchased by Lewis D. Krause from Albright College, School of Theology, of the Evangelical Church, Reading, Pa., and these agreements called for an "annuity of 6 percent" payable to Mr. Krause during his lifetime. It was agreed that the funds received were comingled with other funds of the schools, and that the annuity payments were paid out of the receipts and current income of the schools; and also that the income received from the gifts was less than the annuities paid.

The opinion of the Court, while referring to various Pennsylvania decisions such as Kate A. Grosh, File No. 26,786, Orphans' Court, Lehigh County, Pa., claimed that "taxing transfers intended to take effect in possession or enjoyment at or after death has been the law of this state since the enactment of the Act of April 7, 1826, P.L. 146." "What the statute taxes is the right of succession or the privilege of receiving at death the interest which ceased by reason of the death. Kirkpatrick's Est., 275 Pa. 271; Dolan's Est., 279 Pa. 582."

"As early as Reish v. Commonwealth, 106 Pa. 521, 526, the principle was enunciated by our Supreme Court that, to escape the provisions of the Act, a trinity of circumstances must be present, i.e., the grant must be such as parts with possession, title, and enjoyment in the grantor's lifetime. Todd's Est., (No. 2), 237 Pa. 471; Dolan's Est., supra, p. 588."

It further adds that where the settlor reserves the beneficial enjoyment of the property as long as he lives, the trust fund is subject to the payment of the tax. While referring to Honeyman's estate in New Jersey (Honeyman's Est., 129 Atl. 393) (N.J. 1925); People v. United Christian Missionary Society, 173 N.E. 1932 (*Ill.* 1930); Hamilton's Est., 259 N.W. 433 (*Wis.* 1935), the Court held that these two annuities were not covered by the Act of 1929, which ex-

empted life insurance contracts inasmuch as annuity payments were not included in that act. The appeal was therefore dismissed.

In 1935—the January Term, Case No. 36, the matter of the Estate of John M. Hamilton, deceased, came up in the Supreme Court, State of Wisconsin. The decedent died on May 30, 1932, aged eighty-two years. Between the 22d day of March, 1916, and the 5th day of March, 1931, he purchased two annuities—one from the Board of Foreign Missions of the United Presbyterian Church of North America, and the other from the American Bible Society. An inheritance tax was imposed on these two annuities under Section 72.01 (3) of the state of Wisconsin, covering transfers intended to take effect in possession or enjoyment at or after death.

The annuity of the American Bible Society was purchased April 10, 1926, when the decedent was seventy-six years of age, and paid him $86 in semiannual payments on April and October 10. The state of Wisconsin attempted to collect a tax of $60.74 against this, as it was approved and determined by the trial court—the amount claimed against the Board of Foreign Missions of the United Presbyterian Church of North America being $573.70. A brief of thirty-eight pages was submitted by Fisher and Fisher, attorneys for appellants. The Supreme Court of Wisconsin decided that these annuities were not taxable, and reversed the decision of the County Court for Rock County.