Taxation—*Taxability of Insurance Premiums Deemed Paid by Virtue of Automatic Premium Loan Clauses.*

THE MANUFACTURER LIFE INSURANCE CO. v. MEER
G. R. No. L-2910 Prom. June 29, 1951

Sec. 255 [1] of our National Internal Revenue Code [2] entitled "Taxes on Insurance Premiums" is not a unique law. It has been said that in the United States the most common form of taxation, both of domestic and foreign insurance companies, is a tax on gross premiums received.[3] This "gross premium tax is not a property tax, but is an excise tax, or, otherwise stated, a privilege or franchise tax which the company must pay for the privilege of doing business within the state" and "does not violate the due process clause even though no such gross premium tax is exacted from domestic insurance companies." [4] The validity of the law has never been raised in this jurisdiction, however. But questions involving its application have arisen, particularly whether on account of premium advances under automatic premium loan clauses [5] there are "premiums

[1] "Sec. 255. *Taxes on insurance premiums.*—There shall be collected from every person, company, or corporation (except purely cooperative companies or associations) doing business of any sort in the Philippines a tax of one per centum of the total premiums collected . . . whether such premiums are paid in money, notes, credits, or any substitute for money but premiums refunded within six months after payment on account of rejection of risk or returned for other reason to person insured shall not be included in the taxable receipt . . ."

[2] Commonwealth Act No. 466.

[3] Alabama. Brown vs. Protective Life Ins. Co., 188 Ala. 166, 66 So. 47; Citizens Mut. Ins. Co. v. Lott, 45 Ala. 185, holding it immaterial that part of the proceeds were paid out in dividends.

Georgia. Georgia Fire Ins. Co. vs. City of Cedartown, 134 Ga. 87, 67 S.E. 410, 19 Ann. Cas. 954.

Iowa. In re Continental Casualty Co., 189 Iowa 933, 179 N.W. 185.

Kansas, State ex rel. Hopkins v. Travis, 108 Kan. 257, 195 Pac. 182.

Michigan. People v. State Treasurer, 31 Mich. 6.

New York. People ex rel. Provident Sav. Life Assur. Society v. Miller, 179 N.Y. 227, 71 N.E. 930; People ex rel. Continental Ins. Co. v. Miller, 177 N.Y. 515, 70 N.E. 10; People ex rel Commonwealth Ins. Co. vs. Coleman, 121 N.Y. 542, 25 N.E. 51; People v. Metropolitan Surety Co., 158 N.Y. App. Div. 657, 144 N.Y. Supp. 201.

Ohio. State ex rel. Penn. Mut. Life Ins. Co. of Philadelphia v. Hahn, 50 Ohio St. 714, 35 N.E. 1052.

Pennsylvania. Com. v. Metropolitan Life Ins. Co., 254 Pa. 510, 98 Atl. 1072.

See Cooley, The Law of Taxation, sec. 941.

[4] Great Northern Life Ins. Co. vs. Read, 322 U.S. 47; see 19 Appleman, Insurance Law and Practice, 1946 ed., pp. 288-290.

[5] A sample of an automatic premium loan would be that involved in the case of Manufacturers Life Ins. Co. v. Meer, supra, as follows: "This policy shall not lapse for non-payment of any premium after it has been three full years in force, if, at the due date of such premium, the Cash Value of this Policy and of any bonus

collected," and if so, whether premiums collected are in "money, notes, credits, or any substitute for money." [6] Much importance was placed on the resolution of the question because of the relatively large operation of automatic premium loan clauses during the occupation arising out of the inability of the insured to pay the premiums due during such period. It will be noted that such non-payment would have ordinarily caused the forfeiture of the policies with no right on the part of the insured except to an equitable return of the premiums so far paid. The war cannot be put up as a valid excuse for non-payment. Several cases have so decided.[7]

For the first time, our Supreme Court in the instant case, resolved the question previously mentioned, that is, whether premiums deemed paid by virtue of automatic loan clauses in life insurance policies are taxable [8] under Sec. 255 of the National Internal Revenue Code. The Supreme Court ruled affirmatively on the question.

In this case the plaintiff is an insurance company with head office in Canada, but with a branch office and doing business in Manila. It was engaged in the insurance business at the outbreak of the war, but had to close its branch office in Manila from 1942 up to September, 1945, on account of the war. In the course of its operations before the war, plaintiff issued a number of life insurance policies in the Philippines with non-forfeiture clauses in the nature of automatic premium loans.[9] The insured having failed to pay the premiums due during the occupation, these automatic premium loan clauses were applied by the plaintiff's head office in Canada. The net amount of premiums so advanced or loaned totalled ₱1,069,254.98, out of which ₱158,666.63 have been repaid.[10] Taxes on premiums not repaid were assessed by the defendant Collector of Internal Revenue in the amount of ₱17,917.12, including surplusage. This

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additions and dividends left on accumulation (after deducting any indebtedness to the Company and the interest accrued thereon) shall exceed the amount of said premium. In which event the Company will, without further request, treat the premium then due as paid, and the amount of such premium, with interest from its actual due date at six per cent, per annum, compounded yearly, and one per cent., compounded yearly for expenses, shall be a first lien on this Policy in the Company's favor in priority to the claim of any assignee or any other person. The accumulated lien may at any time, while the Policy is in force, be paid in whole or in part . . ."

[6] A perusal of sec. 255 (see footnote 1) will reveal that these must concur in order that taxes may validly be collected under such provision.

[7] Constantino vs. Asia Life Insurance Co., G.R. L-1669, Aug. 31, 1950; Peralta vs. Asia Life Insurance Co., G.R. L-1670, Aug. 31, 1950; McGuire vs. Manufacturers Life Insurance Co., G.R. L-3581, Sept. 21, 1950; National Leather vs. U.S. Life Insurance Co., G.R. L-2668, Sept. 30, 1950; Hidalgo Vda. de Carrero vs. Manufacturers Life Insurance Co., G.R. L-3032, Oct. 10, 1950; West Coast Life Insurance Company vs. Patricio Gubaras, G.R. L-2810, October 10, 1950.

[8] It must be noted that actually the premiums paid are merely used as the basis in determining the amount of the tax to be collected for the privilege of doing insurance business in the state.

[9] See footnote 5.

[10] Taxes on this amount repaid were paid without protest.

amount was paid under protest. Hence, this action for its recovery.[11]

The Court denied the plaintiff's petition, considering the assessment and collection to be valid. No precedent was cited and not surprisingly, for this is the first case of its kind. This being so, it may, therefore, be well to consider the court's opinion in arriving at its conclusion.

It would be best to note that premiums as a general rule should be paid in cash [12] in the absence of an agreement (which must not however violate the essence of the contract or any prohibitory enactments) or statutory provision to the contrary.[13] In the present case, the provisions of Section 184 (g) of our Insurance Law,[14] and the agreement on the application of the automatic premium loan substitute premium loan for cash payment.

The first question is whether premiums were collected. The Court believed that in effect the insurance company loaned to the insured an amount equal to the premium due, which amount the insured in turn paid to the insurance company. Thus, the insurance company collected premiums. It was argued, however, that there could be no such a collection, as in effect it would make the insurer, a creditor, enable him to acquire a lien on the policy and entitle him to collect interest on the amount of the unpaid premiums. While, it is admitted that the insurer became a creditor and therefore entitled to collect interest, his right to collect interest was not on the premiums, nor of interest thereon, but on the loan.[15] Pressing the point further, however, plaintiff contended that there could not possibly be any collection because its assets remained exactly the same after making the advances in question. The view is not well taken

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[11] See Sec. 306, National International Revenue Code.

[12] "The same doctrine is laid down in Kerr on Insurance citing Hoffman v. Ins. Co., 92 U.S. 161, 23 L. Ed. 539. Mr. Justice Swayne says: 'Life insurance is a cash business. Its disbursements are all in money and its receipts must necessarily be in the same medium. This is the universal usage and rule of all such companies. . . . If the agent had the authority to take the horse in question, he could have taken them in all cases. This would have carried with it the right to establish a stable, employ hands, and do everything else necessary to take care of the horses until they could be sold. The company might then find itself carrying a business alien to its charter, and in which it had never though of embarking. The exercise of such power by the agent was liable to two objections, it was ultra vires, and it was a fraud as respects the company. . . . No valid contract as to the company could arise from such transaction.'" (Folb vs. Firemen's Insurance Company, 45 S.E. 547). See 3 Courch on Insurance, pp. 1933, 1947.

[13] "In the absence of special regulation or agreement, premiums or assessments are payable in money or cash, although it may be, and frequently is, stipulated or agreed otherwise, in which case any agreed medium may be employed, provided the agreement does not violate the essence of the contract or any prohibitory enactments." (3 Courch on Insurance, p. 1933).

[14] Act No. 2427.

[15] Note that such debt could be paid by the insured in either of three ways: (1) by paying it in money; (2) by letting the cash value of the policy compensate it; or (3) in case the insured should die, the debt may be deducted from the policy.

for there actually was an increase in assets. There was the new credit for the advances made. Of course, the plaintiff could not sue the insured to enforce the credit. Yet, it had means of satisfaction out of the cash surrender value. To the argument that satisfying the credit from the cash surrender value would not increase the assets of the company any, the Court answered that: considering that the cash surrender value is an amount which the insurance company holds in trust [16] for the insured to be delivered upon demand, payment out of it would mean a decrease in the liability of the company to the insured, for actually the cash value of the policy is a

[16] The Court in the course of its opinion defined "cash surrender value" thus: "As applied to a life insurance policy, it is the amount of money the company agrees to pay to the holder of the policy if he surrenders it and releases his claim upon it. The more premiums the insured has paid the greater will be the surrender value; but the surrender value is always a lesser sum than the total amount of premius paid. (Cyclopedia Law Dictionary, 3d Ed. 1077)." Vance has this to say: "Most life policies, especially in later years, stipulate that, if the policy shall be in force for a given number of years, usually three, there shall be paid to the insured a certain amount upon his surrendering his policy for cancellation. The amount of this surrender value offered is based upon the reserve value of the policy at the time of surrender, and it is plain that the insurer can well afford to pay to the insured the entire reserve value of his policy in consideration of his surrendering it for cancellation; but, inasmuch as insurance companies desire to discourage the surrender of policies so far as they can equitably do so, the surrender value fixed upon a policy is usually set at a considerably lower figure than that which would be established by its reserve value. It seems that, in the absence of a specified promise so to do, the insurer is under no obligation to pay any portion of the reserve value of a policy upon its surrender." (Vance, Law of Insurance, 2nd ed. pp. 54-56).

Our Supreme Court has previously in some detail explained the nature of "cash surrender value" in the case of Sun Life Assurance Company vs. Ingersoll and Tan Sit, 42 Phil. 331. It will be seen that the holding of the court in this case supports the view that the "cash surrender value" is held in trust by the insurance company for the insured. The Court in that case said: ". . . the surrender value of a policy arises from the fact that the fixed annual premium is much in excess of the annual risk during the earlier years of the policy, an excess made necessary in order to balance the deficiency of the same premium to meet the annual risk during the later years of the policy. This excess in the premium paid over the annual cost of insurance, with accumulations of interest, constitutes the surrender value. Though this excess of premiums paid is legally the sole property of the company, still in practical effect, though not in law, it is moneys of the assured deposited with the company in advance to make up the deficiency in later premiums to cover the annual cost of insurance, instead of being retained by the assured and paid by him to the company in the shape of greatly-increased premiums, when the risk is greatest. It is the 'net reserve' required by law to be kept by the company for the benefit of the assured, and to be maintained to the credit of the policy. So long as the policy remains in force the company has not practically any beneficial interest in it, except as its custodian, with the obligation to maintain it unimpaired and suitably invested for the benefit of the insured. This is the practical, though not the legal, relation of the company to this fund."

It is seen, therefore, that while the naked ownership of the cash surrender value may lie with the company, yet in actuality, the company is but the mere trustee and the insured the cestui que trust of the cash surrender value. The insured's rights therein are more than mere equities. His is the beneficial interest.

liability of the company. The logic of the Court is quite clear, in spite of the view advanced that what the insurance company did was not to lend, but merely to advance, quoting Section 184(g), of Act No. 2427, to wit: "company at any time x x x will advance x x x a sum equal x x x to the reserve at the end of the current policy year x x x." [17] It will be noted, however, that the very clause of the policy uses the word "loan." [18] Furthermore, it may be stated that "x x x in determining whether the transaction is a loan or the payment of a premium the word loan must not be too strictly construed," and that "it is not necessary to the creation of a loan that the money should be paid on one hand and received on the other, for the matter of a man's money remaining in another's hands, as a result of the agreement will equally constitute a loan." [19] And then it will be seen that the interpretation given by the court is in consonance with the rule that "the test of the meaning of words commonly used, should be their ordinary and popular meaning" [20] and "should be construed strictly against the person (insurer) using them." [21]

But if there was payment, was the payment in "money, notes, credits, or any substitute for money" as required by the same section of the Internal Revenue Code? The Court ruled affirmatively on this point on the ground that the insurer "agreed" to consider the premium paid on the strength of the automatic loan. It will be further noted that under the agreement the amount corresponding to the premium considered paid bears interest and is a first lien on the policy, giving the transaction in this insurance all the earmarks of a payment in "credit." This, manifestly, is but consistent with the first conclusion that the insurance company lent the insured, which money owned in turn was applied in payment of the loan.

The insurance company also alleged that there was double taxation because the "advance" (as they alleged it to be) was taken from the cash value of the policy, which cash value had already been subjected to the same tax, consisting of previous premiums, paid. The court in disposing of the argument, stated that the argument assumes erroneously that all advances are necessarily repaid from the cash surrender value because there are instances where there is a remittance of the money. The statement of the court may be misleading in that it might imply that if there should be no remittance

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[17] The Insurance Law.

[18] See footnote 5. It was claimed that this was a mere grammatical misnomer.

[19] Paul vs. Columbian Nat. L. Ins. Co., 15 A. 2d 636. The case of McAdams vs. Randolph, 41 N.J.L. 218, 221, was cited.

[20] Cleaver vs. Central States L. Ins. Co., 142 S.W. 2d, 474, 477.

[21] "'The insurer has the opportunity to have the language of the contract selected with great care and deliberation by experts and legal advisers acting exclusively in its interests, and it is responsible for any ambiguities found therein. . . . It is, therefore, well established that where the meaning of a policy provision is doubtful or susceptible of different constructions, the policy should be construed strictly against the insurer and liberally in favor of the insured.' Henderson v. Massachusetts Bonding & Ins. Co., 337 Mo. 1, 84 S.W. 2d 922, 924." (Paul v. Columbian Nat. L. Ins. Co., 15 A. 2d, 636). See also Vance on Insurance, 2nd ed. 303.

by the insured, there would be double taxation. The court should have relied solely on the fact that the tax being collected is on a new premium and not on past premiums. In this instance it would be quite immaterial how this payment is made so long as there is payment, in which event there is at once something to be taxed. The court then, added "in any event there is no constitutional prohibition against double taxation." [22]

The plaintiff argued that as the advances of premiums were made in Toronto, such premiums are deemed to have been paid there and not in the Philippines, and therefore, not subject to local taxation. The Court in overruling this contention said that "the thesis overlooks the fact that the loans are made to policyholders in the Philippines, who in turn pay therewith the premium to the insurer thru the Manila branch." Arguing from effect, the Court proceeded to say that "approval of appellant's position will enable foreign insurers to evade the tax by contriving to require that premium payments shall be made at their head office." It is believed that in considering this point it would be well to consider the nature of the tax—that such a tax is generally held to be an excise rather than a property tax.[23] For then it will be seen that actually it is not the payment which is being taxed, but the privilege granted to companies to pursue the insurance business. This is made emphatic when we consider that "the law does not contemplate premiums collected in the Philippines." As the Court opined: "It is enough that the insurer is doing insurance business in the Philippines, irrespective of the place of its organization and establishment." Presumably this is the reason why the Court did not even discuss appellant's contention regarding the territoriality of tax laws and the situs of intangible personalty.

Finally the plaintiff contended that it was not engaged in business in the Philippines during the years 1942 to September 1945, which fact, it will be noted, has become material in view of the preceding arguments and because section 255 applies only to companies "doing insurance business in the Philippines." Although plaintiff's contention is factually true, yet, the Court overruled it, considering that "still it was practically and legally operating in this country by collecting premiums on its outstanding policies, incurring the risk and/or enjoying the benefits consequent thereto, without having previously taken any steps indicating withdrawal in good faith from this field of economic activity."

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[22] "In this jurisdiction double taxation of the same property either to the same or different persons, while not unlawful, should, wherever possible, be avoided and prevented (De Villata vs. Stanley, 32 Phil. 541). But says Justice Holmes, the due process clause 'no more forbids double taxation than it does doubling the amount of a tax, short of confiscation or proceedings unconstitutional on other grounds' (Ft Smith Lumber Co. vs. Arkansas, 251 U.S. 532)." Sinco, Phil. Political Law, 2nd Rev. Ed., p. 509.

[23] Equitable Life Assurance Society vs. Pennsylvania, 238 U.S. 143; See Cooley, The Law of Taxation, sec. 847.