REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

THE INSULAR LIFE ASSURANCE COMPANY, LTD.,
Petitioner,

- versus -

C.T.A. CASE NO. 5336

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

DEC 29 1997

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D E C I S I O N

This is an appeal from the decision of the respondent denying petitioner's request for the reconsideration and cancellation of several assessment notices issued against it for deficiency premium tax and penalty for late payment of premium tax covering the years 1993 and 1994 in the amount of ₱34,247,226.90, inclusive of 25% surcharge and 20% interest per annum; and for deficiency documentary stamp tax for the years 1990 to 1994 in the amount of ₱326,121,436.47, inclusive of 25% surcharge, all in the aggregate sum of ₱360,368,663.37.

Petitioner is a non-stock mutual life insurance corporation duly registered under Philippine laws with principal address at Insular Life Building, 6781 Ayala Avenue, Makati City, Metro Manila.

The facts are as hereunder stated.

On February 24, 1988, petitioner applied with the respondent for an exemption from the payment of premium tax and documentary stamp tax, as provided respectively in Sections 121 and 199 of the National Internal Revenue Code ("Tax Code" for brevity) on the ground that, as a mutual life insurance company, it is a cooperative company and, therefore, exempt from the payment of said taxes.

After initially gathering information on the corporate profile of the petitioner during the first half of 1988 and holding a preliminary conference with it on February, 1989 as well as the receipt of its final supplementary paper on April 2, 1990, respondent, however, inexplicably was not able to render any resolution on petitioner's request. So on February 15, 1995 or nearly five years since the submission of the supplementary paper, petitioner wrote respondent a follow-up letter on the matter.

In response, respondent issued a Letter of Authority, dated June 9, 1995, which was received by the petitioner on June 13, 1995, authorizing its revenue officers who are with the Tax Fraud Division to examine petitioner's books of accounts and other financial records for any liability on income, value-added, withholding and documentary stamp taxes for the year 1994.

Respondent conducted the examination and issued on August 10, 1995 a notice of her proposed tax deficiency assessments, which have been limited to documentary stamp and premium taxes, together with a request for an informal conference with the petitioner. Forthwith on August 30, 1995, petitioner filed its letter of protest of even date against such proposed tax deficiency assessments contending that the issuance of the latter was irregular and premature in view of the pendency of its request for exemption from premium and documentary stamp taxes.

Despite the protest, however, petitioner received from the respondent on January 5, 1996 several assessment notices, all dated September 29, 1995, issued against it for deficiency documentary stamp and premium taxes and penalty for late payment of premium tax, as follows:

Deficiency documentary stamp tax

Assessment Notice No.	Year	Basic Tax	25% Surcharge	Total Amount Due and Collectible
C-1-90-DST-075-95	1990	₱ 42,038,511.31	₱10,509,627.91	₱ 52,548,139.22
C-1-91-DST-074-95	1991	45,288,437.72	11,322,109.44	56,610,547.16
C-1-92-DST-073-95	1992	49,665,937.78	12,416,484.45	62,082,422.23
C-1-93-DST-072-95	1993	53,309,296.15	13,327,324.03	66,636,620.18
C-1-94-DST-071-95	1994	70,594,966.15	17,648,741.53	88,243,707.68
		₱260,897,149.11	₱65,224,287.36	₱326,121,436.47

Premium tax

Assessment Notice No.	Year	Basic Tax Due	25% Surcharge	20% Interest P.A.	Total Amount Due and Collectible
C-1-93-Prem-077-65	1993	₱ 7,833,870.48	₱1,958,467.62	₱3,318,515.67	₱13,110,853.77
C-1-94-Prem-076-95	1994	12,626,439.83	3,156,609.96	2,192,092.00	17,975,141.79
		₱20,460,310.31	₱5,115,077.58	₱5,510,607.67	₱31,085,995.56

Penalty for late payment of premium tax

Assessment Notice No.	Year	Basic Tax Due	25% Surcharge	20% Interest P.A.	Total Amount Due and Collectible
C-1-94-Prem-078-95	1994	₱10,115,940.27	₱2,528,985.07	₱3,318,515.67	₱3,161,231.34

In a letter, dated January 15, 1996, and filed on January 19, 1996 with the respondent, petitioner requested for a reconsideration of the aforementioned assessments. Thereafter, on March 15, 1996, petitioner received a copy of the letter of the respondent, dated February 22, 1996, denying its request for reconsideration. Hence, this petition for review filed on March 22, 1996.

At bar, petitioner reasserts its stance *a quo* by maintaining that Sections 199 and 121 of the Tax Code provide specifically for the exemption from documentary stamp and premium taxes, respectively, of cooperative insurance companies or associations. It claims that a mutual life insurance company is a cooperative association as enunciated in American jurisprudence, to wit:

> "a mutual insurance company xxx might be described as a cooperative enterprise, wherein the members constitute both insurer and insured, where the members all contribute, by a system of premiums and assessments to the creation of a fund from which all losses and liabilities are paid, xxx." **(Minnick v. State Farm Mutual Automobile Insurance Company,** 174 Atlantic Reporter, 2d Series, 706, 709 [1961]);
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> "A mutual insurance is a cooperative enterprise in which the members are both insurers and insured; the Company is owned and managed by the policyholders; the business is conducted for their benefit; they are the owners of the profits and the surplus and thus a policyholder has rights, both as an insured and as a co-owner of the assets of the Company." **(Public Housing Administration v. Housing Authority of Bogalusa,** 137 Southern Reporter, 2d Series, 315, 321 [1962]);
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> "A mutual insurance company is a cooperative enterprise in which policyholders constitute the members for whose benefit the company is organized, maintained and operated." **(Fidelity & Casualty Company of New York v. Metropolitan Life Insurance Company,** 248 New York Supplement, 2d Series, 559; 42 Misc. 2d 616 [1963]);
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> "'Mutual insurance' exists where several persons have joined together for their united protection with each member contributing to a fund for payment of losses and expenses, and with benefit or indemnity to accrue to any individual member, depending on existence of other persons holding similar contracts, and relationship between members is dual one in that each member is in sense both insured and insurer." **(Pella Farmers Mutual Insurance Company v. Hartland Richmond Town Insurance Company,** 132 North Western Reporter, 2d Series, 225; 26 Wis. 2d 29. [1965]);

> "A mutual company is one in which the distinguishing feature is the mutuality of cooperation of the members united for the purpose, each taking a proportionate part in the management of its affairs and being at once insurer and insured, participating alike in its profits and losses, all of its members being policyholders." (**Ohio Farmers Indemnity Company v. Commissioner of Internal Revenue,** 108 Federal Reporter, 2d Series, 665, 667 (1940)

Petitioner further asseverates that a mutual life insurance company has all the characteristic features or elements of a cooperative association, as defined in Section 121 of the Tax Code, namely: 1) it is managed by members/policy holders; 2) it is operated with money collected from members; and, 3) it has for its main purpose the mutual protection of members and not for profit. Elaborating on the first characteristic, it avers that a policy holder in a mutual insurance company is a member of a cooperative. In support thereof, it invokes as authority the hereunder quoted American cases, thus:

> "A policy holder in a mutual insurance association stands in a two-fold relation towards the company. He is a policy holder and he is a member." (Citing Condon vs. Mutual Reserve Association, 44 L.R.A. 149). **Petition of Charlton Bros. Transportation Company, Inc.,** 30 A2d 538 (1942).

> "It may be stated generally that a mutual insurance company is a cooperative enterprise, wherein the members are both insurer and insured, the policy holders constituting the membership and sustaining a dual relationship

> *inter se*, with a two-fold interest as both insurer and insured to contribute to payment of losses and entitled to payment of loss and to a proportionate share in profits." **Keehn v. Hodge Drive-It-Yourself, Inc.**, 53 North Eastern Reporter, 2d Series, 69, 71 (1943).

Applying the above interpretations to its situation, petitioner refers back to Articles 3 and 4 of its Amended By-Laws in exhibiting the fact that its ownership is vested in its members who are all equally entitled to one vote each, with its management exercised through a duly elected Board of Trustees.

As regards the second characteristic of a cooperative association, petitioner points out that the premiums contributed by its policyholders or members are pooled in a common fund in the same way that money in a cooperative is collected from among its membership. It quotes the following cases in support of its argument, *viz.*:

> "The members made up a common fund by means of their mutual or common contributions upon which each had a claim for any loss in respect to the property insured. There was no other responsibility on them, which is one of the characteristics of a mutual company. Joint stock companies have a subscribed capital and their policyholders have nothing to do with the management of the company. Mutual companies have no capital stock and depend solely upon their premiums and their affairs are managed by the policyholders. These are the distinguishing features of the two and whether the premiums were paid in cash or by notes has nothing to do with the distinction. Mygatt vs.

> New York Protection Insurance Company, 21 N.Y. 52; Ohio Mutual Insurance Company vs. Marietta Woolen Factory, 3 Ohio St., 348; Union Insurance Company vs. Hoge, 62 U.S. 35, 65, 21 How. 35, 16 L.Ed. 61" **Ohio Farmers Indemnity Company v. Commission of Internal Revenue,** 108 Federal Reporter, 2d Series, 665, 667 (1940).
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> "A mutual company is one in which the members are both the insurers and the insured; and the premiums paid by them, constitute the fund which is liable for the losses and expenses, and they share in the profits in proportion to their interest, and control and regulate the affairs of the company." **Pink v. Town Taxi Company,** 21 Atlantic Reporter, 2d Series, 656, 659 (1941)
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> "When it is considered that the term 'mutual', as applied to an insurance company, does not import any peculiar and exact method of producing mutuality, in the sense of equity among its members, but that it is simply significant of an association for the purpose of insurance, whose fund for the payment of losses consists, not of a capital furnished by uninsured parties, but of the premiums mutually contributed by the persons insured, all difficulty on the subject is at an end." **Muller v. State Life Insurance Company,** 60 N.E. 958, 960 (1901).

With respect to the third characteristic of a cooperative association, petitioner further cites the case of **Pink v. Town Taxi Co., Inc.,** supra at 659, in buttressing her position that the primary purpose of a mutual insurance company is the mutual protection of its policyholders-members, as likewise provided in Section 262 of the Insurance Code and Article 7 of its Amended Articles of Incorporation, to wit:

> "Mutual insurance is that system of insurance by which the members of the association or company mutually insure each other. A mutual company, therefore, is one in which the members are both the insurers and the insured."

Petitioner explains that the intent of policyholders in obtaining policies of insurance from it is solely to buy insurance protection for themselves. The premiums paid by policyholders answer directly for the cost of insurance protection, which includes its operating costs and benefits paid under the insurance policies.

In tackling the aspect of not having any profit as a cooperative association, petitioner contends that policyholders in a mutual life insurance company are not like stockholders in ordinary corporations who pay and invest money for shares of stock in order to earn profits by way of dividends; that although the policyholders receive dividends by reason of their policies, the same do not constitute profit distributed by a mutual life insurance company such as petitioner but rather, represent a refund of excess premiums collected by policyholders in the form of dividends[1]; and that the dividends distributed by a mutual insurance company act as a return to policyholders of excess premiums over

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1 citing the case of **Grepalife v. Commissioner of Internal Revenue**, CTA Case No. 2342

actual cost of operations of the company which in effect, reduces the cost of insurance to the members[2]

Finally, petitioner elucidated on the government's policy of encouraging mutualization of insurance companies. It quotes the statement of former BIR Commissioner and retired Justice of the Supreme Court, Efren I. Plana, as released by the Tax Information and Education Division of the BIR (cited in National Internal Revenue Code, Annotated by De Leon, pp. 64-65, 1989 ed.) in justifying the special tax treatment given to mutual life insurance companies, thus:

> "A mutual life insurance company is a form of life insurance corporation in which there are no stockholders. The policyholders of a mutual life insurance company own and control the corporation. <u>It is the policy of the government to encourage mutualization, which actually means the transfer of control of the company from the stockholders to the policyholders. The conversion of the stock life insurance company into mutual form is one of the convenient means of achieving the policy of the government to redistribute and disperse the concentration of wealth. It is for this reason that mutual life insurance companies are given special tax treatment in the Tax Code of 1977</u>.

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2 citing the cases of **C.J. Simons and Co. v. American Mutual Liability Insurance Co.**, 257 A 2d 743 (1969); **Mutual Fire Ins. Co. of Georgetown v. United States**, 142 F. 2d 344, 347-348 (1944); **Keystone Mut. Casualty Co. v. Driscol**, C.C.A. Pa., 137 F. 2d, 907,911 (1943); **American Ins. Co. of Texas v. Thomas**, C.C.A. Tax, 146 F. 2d 434,436 (1944); **Mutual Fire Ins. Co. of Germantown v. U.S.**, C.C.A. Pa., 50 F. Supp. 665, affirmed C.C.A. 142, F. 23, 344, certiorari denied 65 S. Ct. 65 323 U.S. 729, 89 L.Ed. 2d 585 (1943); **Garofano Const. Co. v. Lumber Mut. Casualty Ins. Co. of New York**, 26 N.Y.S. 2d 780 (1941), 176 Misc. 159; **Wells v. Metropolitan Life Ins. Co.**, 13 N.Y.S. 2d 22, at pages 26,27 (1939), 171 Misc. 878.; and, **Mutual Fire Ins. Co. of Germantown v. United States**, 142 F2d 344, 347 (1944).

> Considering further that a mutual life insurance company operates on the principle that policyholders mutually insure each other's lives with claims and expenses being equitably apportioned over the entire group of policyholders and the divisible surplus being distributed in an equitable manner in the form of participating dividends to those who contributed to its accumulation, <u>this mode of operation partakes of the nature of a cooperative and justifies a special tax treatment.</u>" (Emphasis supplied)

Respondent, on the other hand, argues in her answer, by way of special and affirmative defenses, that petitioner cannot be considered a cooperative company or association as contemplated under Sections 121 and 199 of the Tax Code; that petitioner is liable to pay a tax of five per cent (5%) on the total premiums collected by it as provided under Section 121 of the Tax Code; that petitioner is liable to pay documentary stamp tax on all policies of insurance or annuities it has issued; and that all told, petitioner has no cause of action.

In her memorandum, respondent expounded on her opposition to petitioner being considered a purely cooperative company or association as contemplated in Section 121 of the Tax Code. While she puts forth no dispute on the mutualization of the petitioner, she begs to disagree on petitioner's allegation that it is a purely cooperative company. She insists that, as defined in Section 2 of Presidential Decree No. 175 and as cited in the Philippine Law Dictionary, "a cooperative company is an organization composed primarily of small producers and consumers who voluntarily join together to form business enterprises which they themselves own, control or patronize." This definition, according to her, suggests that a cooperative company is normally composed of a small group of individuals of which petitioner is not.

In addition, respondent asserts that under Section 199(1) of the Tax Code, a cooperative company should also be operated on the lodge system or local cooperation plan. Concentrating on the nature of a lodge system, respondent explains, thus:

> The phrase "operating under a lodge system" means the carrying on of activities under a form of organization that comprises local branches which are chartered by a parent organization and largely self-governing groups called lodges, chapters or the like (Sec. 27, Rev. Regs. No. 2). Organizations are "operating under the lodge system" only when they have a parent and local organization which are active (Western Funeral Benefit Association v. Hoolich 2f (2d) 367; Law of Federal Income Taxation, Westeros, Vol. VI, p. 8). Furthermore, there must be a fraternalistic feature or something more than the desire on the part of the members to protect each other financially (Atlantic Coast Line R & Co. v. U.S. TAFTR 9991 [CT. CI. 1928]: Family Aid Association of U.S. of Prayle for All People v. U.S., 36 F. Supp. 1017 [CT. C. 1941].

Also, respondent contends that the qualities of a cooperative company as stated in the second paragraph of Section 121 of the Tax Code are absent in a mutual life insurance company. She alleges that during the cross examination of petitioner's witness, Mr. Jose B. Quimson on August 7, 1996, the latter admitted that petitioner is not operating under the lodge system; that it has no fraternalistic feature; that its members do not know each other; and that, it is earning profits.

Furthermore, respondent ratiocinates that when the law making body enacted Sections 121 and 199 of the Tax Code, it already had full knowledge of the existence of the two(2) entities called "cooperatives" and "mutual life insurance companies" as well as laws separately governing them. Thus, under the principle of statutory construction, "exclusio unios, exclusio est alterios" or what is not included, is deemed excluded, respondent concludes that the omission of mutual life insurance companies in Sections 121 and 199 of the Tax Code is not a legal vacuum but a deliberate choice not to exempt them from the taxes herein involved.

Lastly, respondent springs a surprise by positing that this Court has no jurisdiction over the case at bar. She reasons out that the decision appealed from as contained in the letter dated February 22, 1996 which was received by the petitioner on March 26, 1996, supra, is not a ***final*** decision because said letter did not indicate that the same is her final decision on petitioner's protest in accordance with the dictum of the Supreme Court in **Surigao Electric Co. Inc. v. Court of Tax Appeals**, 57 SCRA 523. She adds that there was not even a demand for the payment of the deficiency tax assessment. She remarks thus that petitioner's request for reconsideration of the assessments as stated in its protest letter dated January 15, 1996 did not actually constitute a request for the reconsideration of respondent's decision, as contemplated by law.

In its memorandum, petitioner mainly reiterated its arguments as contained in the petition at bar. However, it specifically countered that this Court has jurisdiction to entertain the instant petition pursuant to Section 229 of the Tax Code. It emphasizes the fact that the letter of the respondent, dated February 22, 1996, which denied its protest of the herein assessments in a letter, dated January 15, 1996, unequivocally shows the final decision of the respondent. In addition, it bolsters its proposition that dividends given to its policyholders are not, strictly speaking, profits by relying on the case of **Philippine American Life Insurance Company vs The Commissioner of Internal Revenue, et al,** CTA Case No 1689, as affirmed by the Supreme Court in G.R. No. L-38292.

After a minutiose scrutiny of the facts, the disquisition of the parties and the applicable laws and jurisprudence in point, we arrive at the following issues, namely:

1. Whether or not a final decision has been rendered by the respondent on the protest made by the petitioner upon assessments at bar; and,

2. Whether or not petitioner is a purely cooperative insurance company entitled to exemption from the payment of premium tax and documentary tax as provided in Sections 121 and 199 of the Tax Code, respectively.

Anent the first issue, this Court is of the firm belief that respondent has issued a final decision on the protest filed by the petitioner pursuant to Section 229 of the Tax Code. We find the argument of the respondent that there was no final decision to be quite inane and more reflective of an afterthought as can be readily discerned from her failure to alleged the same in her answer or during the trial proceedings. It was only during the submission of her memorandum that she belatedly broached such argument.

Be that as it may, there is no doubt that respondent issued the assessments at bar against the petitioner. In fact, respondent admits in her memorandum (p. 441, docket) that said assessments were issued by her on September 29, 1995 (received by the petitioner on January 5, 1996). On this score, Section 229 of the Tax Code is clear and unambiguous in stating that "[s]uch assessment may be protested administratively by filing a request for reconsideration or reinvestigation in such form and manner as may be prescribed by implementing regulations within thirty (30) days from receipt of the assessment.." Petitioner filed the requisite protest on January 19, 1996 which is well within the 30 day period. Consequently, respondent denied the same in a letter dated February 22, 1996 (received by the petitioner on March 26, 1996), the dispositive portion of which reads:

> "In view of the foregoing, we regret to deny your request for reconsideration and hereby affirm the assessments above-mentioned."

From the above, petitioner instituted the present action on March 29, 1996.

To our mind, the aforementioned letter, dated February 22, 1996, which was signed by the respondent herself indicates in clear and unequivocal language her final decision on the disputed assessments. The statement "we regret to deny your request for reconsideration" is too plain to be misconstrued. It satisfies the High Court's dictum in the Surigao case, *supra*, that the respondent should always indicate what constitutes her final determination on disputed assessments so as not to leave taxpayers groping in the dark. In this instance, she has rendered that kind of final decision.

As regards the second issue, this Court rules in favor of the petitioner. A mutual insurance company such as petitioner is a purely cooperative company.

For easy reference, the pertinent provisions of the Tax Code are herein-below quoted, to wit:

> **SEC. 121.** ***Tax on insurance premium*** - There shall be collected from every person, company, or corporation (**except purely cooperative companies or associations**) doing insurance business of any sort in the Philippines a tax of five per centum (5%) of the total premium 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 a person insured shall not be included in the taxable receipts; nor shall any tax be paid upon reinsurance by a company that has already paid the tax; nor upon premiums collected or received by any branch of a domestic corporation, firm or association doing business outside the Philippines on account of any life insurance of the insured who is a non-resident, if any tax on such premiums is imposed by the foreign country where the branch is established nor upon premiums collected or received on account of any reinsurance, if the risk insured against covers property located outside the Philippines, or the insured, in case of personal insurance, resides outside the

> Philippines if any tax on such premiums is imposed by the foreign country where the original insurance has been issued or perfected; nor upon the portion of the premiums collected or received by the insurance companies on variable contracts (as defined in Sec. 232(2) of Presidential Decree No. 612) in excess of the amount necessary to insure the lives of the variable contract owners.
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> **Cooperative companies or associations are such as are conducted by the members thereof with the money collected from among themselves and solely for their own protection and not for profit.** (Emphasis supplied)
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> SEC. 199. ***Documents and papers not subject to stamp tax.*** - The provisions of Section 173 to the contrary notwithstanding, the following instruments, documents, and papers shall be **exempt** from the documentary stamp tax:
>
> (1) **Policies of insurance or annuities made or granted by a fraternal or beneficiary society, order, association, or cooperative company, operated on the lodge system or local cooperation plan and organized and conducted solely by the members thereof for the exclusive benefit of each member and not for profit.**
>
> xxx xxx xxx
>
> (Emphasis supplied)

As defined above, cooperative companies are such as are: (1) conducted by the members thereof, (2) with the money collected from among themselves and solely for their own protection and, (3) not for profit.

Petitioner has demonstrated that its management and affairs are conducted by its member-policyholders. Article 7 of its Amended Articles of Incorporation (Exh.

"A") indubitably shows that petitioner has been converted to a non-stock mutual life insurance corporation for the benefit of its policyholders pursuant to Section 266, Title 17 of the Insurance Code of 1978. Under such set-up, the ownership of petitioner is vested in its members who are entitled to one vote each and who, in turn, elect the members of the Board of Trustees from among themselves. (Exhs "B-1" to "B-4"; Amended By-laws of the petitioner) The Board of Trustees on its part, exercises the powers and conducts the business of the corporation. (Exh "B-4")

From the above, we can see the actual democratic participation of all the members of the petitioner in their choice of who should represent them in the running of corporate affairs. In this sense, petitioner can be rightfully said to be solely conducted, managed or guided by its member-policyholders.

Likewise, it cannot be gainsaid that member-policyholders pay money premiums from among themselves for their exclusive benefit and protection from risks assumed by insurance policy. Inasmuch as petitioner is composed of members who are all policyholders thereof, all premiums collected are entirely sourced from the members only. Such premiums collected are then pooled and earmarked for payment of indemnity and benefit claims of member-policyholders (TSN, dated December 12, 1996, pp. 10-14)

The aforementioned payment of indemnity and benefit claims clearly represent the type of protection constitutive of a cooperative company. Being a life insurance company, petitioner is formed or organized to save any individual or master policyholder harmless from loss, damage, or liability arising from any unknown or future or contingent event, or to indemnify or to compensate any individual or master policyholder for any such loss, damage, or liability. (Section 185, Insurance Code)

It is worthy to note that the preceding conclusions we have reached are in conformity with relevant United States decisions cited by petitioner, *supra*, pp. 6-8, namely: **Petition of Charlton Bros Transportation Company, Inc., Keehn v. Hodge Drive-It-Yourself, Ohio Farmers Indemnity Company v. Commissioner of Interal Revenue, Pink v. Town Taxi Company and Muller v. State Life Insurance Company.**

On the contentious aspect of whether it is earning profits or not, We are of the opinion that petitioner is not organized for "profit" as commonly understood in ordinary or business parlance.

We start our discussion by noticing the fact that the collected premiums of all domestic life insurance companies are invested in a strictly regulated environment. Sections 203 and 206 of the Insurance Code prescribes the manner by which the premiums are to be invested, thus:

> **SEC. 203.** Every domestic insurance company shall, to the extent of an amount equal in value to twenty-five per centum of the minimum paid-up capital required under section one hundred eighty-eight, invest its funds only in securities, satisfactory to the Commissioner, consisting of bonds or other evidences of debt of the Government of the Philippines or its political subdivisions or instrumentalities, or of government-owned or controlled corporations and entities, including the Central Bank of the Philippines; Provided, That such investments shall at all times be maintained free from any lien or encumbrance and Provided, further, That such securities shall be deposited with and held by the Commissioner for the faithful performance by the depositing insurer of all its obligations under its insurance contracts. The provisions of section one hundred ninety-two shall, so far as practicable, apply to the securities deposited under this section.
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> Except as otherwise provided in this Code, no judgment creditor or other claimant shall have the right to levy upon any of the securities of the insurer held on deposit under this section or held on deposit pursuant to the requirement of the Commissioner. (As amended by PD 1455)
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> **SEC. 206.** After satisfying the minimum capital investment required in section two hundred three, any life insurance company may invest its legal policy reserve, as provided in section two hundred eleven or in section two

> hundred twelve, in any of the classes of securities or types of investments described in sections one hundred ninety-eight, two hundred, two hundred one and two hundred two, subject to the limitations therein contained, and in any securities issued by any "registered enterprise" mentioned in section two hundred four, free from any lien or encumbrance, in such amount as may be approved by the Commissioner. Such company may likewise invest any portion of its earned surplus in the aforesaid securities or investments subject to the aforesaid limitations. (Underscoring supplied)

As an outcome of investment, income is earned particularly by the petitioner and with it, a tax of 10% of its gross investment income is imposed by the Government under Section 24(d) of the Tax Code, thus:

> **SEC 24..** ***Rates of tax on domestic corporations.***
>
> x x x
>
> (d) *Mutual life insurance companies.* — Mutual life insurance companies organized in and existing under the laws of the Philippines shall pay a tax of 10% of their gross investment income consisting of interest, dividends, rents, net capital gains, and income from any other business than life insurance derived from all sources, except those covered by paragraph (e) hereof. (Underscoring supplied)

In view of the above, it may be stated beyond cavil that petitioner is earning income or "profits", otherwise there is nothing to tax at all. Despite this hard fact, however, we are not predisposed to adjudge petitioner as a non-cooperative company due to the following underlying reasons:

First, an acceptance of the fact that every type of domestic insurance company earns profit by virtue of its taxable investment is directly inconsistent with the provision in Section 121 of the Tax Code exempting cooperative insurance companies from premium tax. We have to bear in mind that cooperative insurance companies must not be for profit. Yet, under the Insurance Code, they are required to invest and realize income. On account of this apparent conflict, We believe that our legislature did not so intend to treat investment income to be equivalent or synonymous to a real business profit.

Secondly, said investments are mandated by law. Hence, a mutual life insurance company cannot be glaringly accused of engaging in personal business motives. We believe that the determining factor in what constitutes profit as described in Section 121 of the Tax Code should be the ownership composition and the purpose of the existence of the insurance company.

If an insurance company is wholly owned by member-policyholders and created for their exclusive protection against insurable risks such as death, injury and accident, we can safely conclude that the protection of life from untoward vicissitudes is the unifying purpose of the member-policyholders in establishing the company. On the other hand, an insurance company that is owned by the few and organized primarily for making income through the offer of insurance services to non-owning public clientele can be said to be one that earns profit as contemplated under Section 121 of the Tax Code. From the facts of the instant case, petitioner falls under the first category because the purpose of its existence is the sole protection of all its member-policyholders.

Lastly, it must be observed that as defined under Section 121 of the Tax Code, the money collected by a cooperative company should come "from among its members and solely for their own protection and not profit". This provision of law would show that the investments made by the petitioner from the money collected from its members are, in effect, intended for the supplementary protection of the member-policyholders and not for profit motives. Jurisprudence has established that income or profit realized from investments which are distributed to member-policyholders in the form of "dividends" are deemed as mere return on excess premiums and not profit. In the aforementioned case of **Philippine American Life Insurance Company vs. The Commissioner of Internal Revenue, CTA Case No. 1689** which was upheld by the

Supreme Court in G.R. No. L-38292 through a Resolution dated March 8, 1974, this Court held, thus:

> "The question for our consideration is one of first impression in this jurisdiction. There are, however, precedents in the United States that can very well be applied in this jurisdiction.
>
> Under the so-called 'level premium plan,' the amount of premium paid by a policy holder during the earlier years are in excess of the current cost of his insurance. Such excess, in life insurance company, constitutes its margin of safety and must be sufficiently large to assure the company's ability to pay its claim as they accrue beyond peradventure. The policy is issued at a fixed premium. That stipulated premium cannot be increased, but may be lessened annually by so much as the experience of the preceding year has determined it to have been greater that the cost of carrying the insurance, and the difference between the amount of the stipulated premium and the cost of carrying the risk constitutes the so-called dividend. The stipulated premium in participating policy is invariably greater than the fixed premium in non-participating policy issued at the same age and upon the same term. This is the kind of dividend which petitioner paid to its participating policy holders <u>This dividend, however, is not in any real sense a dividend. It operates merely to abate or reduce the stipulated premium to the extent that it has been determined by experience that the policy holder paid for his insurance during the preceding year more than it actually cost petitioner to carry the risk. This excess payment represents, not profits or receipts, but overpayment. It is an overpayment because being entitled to his insurance at cost and having paid by way of premiums more than its cost, he is equitably entitled to have such excess applied for his benefit</u>.
>
> > xxx The members contribute for a common object to a fund which is

> their common property; it turns out that they have contributed more than is needed, and therefore more than ought to have been contributed by them, for this object; and accordingly their next contribution is reduced by an amount equal to their proportion of this excess. I am at a loss to see how this can be considered as a 'profit arising or accruing to them from a trade or vocation which they carry on. It is true the alternative is allowed them of leaving the excess in the common fund, and so increasing their representatives' claim upon it in case of death; but I cannot think that this makes any difference. Mr. Bremner truly pointed out that, if these so-called bonuses were to be regard as representing profits, it followed that, if the premiums were trebled, the profits would be increased in proportion. (New York Life Ins. Co. v. Styles, 59 L.J.O.B. 291, L.R. 14 App. Cas 381 [1889] cited in Mutual Benefit Life Ins. Co. v. Harold, 198 Fed. 199, Aff'd Circuit Court of Appeals [3rd Cir.] 201 Fed. 918.) (Underscoring supplied)

Likewise, in the abovecited United States case of **Wells vs. Metropolitan Life Insurance Company**, it was ruled:

> "The average policyholder purchasing a participating policy in a mutual company believes that his policy represents an investment and that he will share in the 'profits' of the company. That, however, is not the fact. <u>The so-called 'dividends' are not dividends at all, in the accepted and ordinary sense of the word. In fact they represent an excess premium or over-charge paid by the policyholder, and then returned to him,</u>

> without interest, less the costs attendant upon collection and administration and various other deductions. In Rhine v. New York Life Ins. Co., 248 App. Div. 120, 289 N.Y.S. 117, affirmed 273 N.Y.1, 6 N.E.2d 74, 108 A.L.R. 1197, Mr. Justice Dore, writing for a unanimous Appellate Division, said, 248 App. Div. at page 125, 289 N.Y.S. at page 123: 'As the policyholders in a mutual life insurance company have paid in more than was necessary, they are entitled to a return of such overpayments. The dividends of a **mutual life insurance company** are, accordingly, strictly speaking, not profits as in the case of an ordinary corporation, but really constitute a return to the policyholder of the amount he has been overcharged for his insurance. In life insurance companies operating on the mutual plan the whole of the divisible surplus is distributed among the members annually as equally as may be in the proportions in which they have contributed to it.' (Emphasis and underscoring supplied)

As such, the "dividends" work to reduce the amount of the premiums priorly paid by member-policyholders. The investments from which the income or profit accrues can thus be seen as a sort of protection against payment of high premiums. More specifically, the investments are not really for profit taking but rather, for reducing the cost of carrying the insurance.

Overall, therefore, petitioner has satisfied the essential attributes of a purely cooperative company. Acknowledging their persuasive effect, United States jurisprudence lends support to the fact that a mutual insurance company is at the same time a cooperative company, as stated, *supra*, pp. 4-6, in the cases of

Minnick v. State Farm Mutual Auto Insurance Company, Public Housing Administration v. Housing Authority of Bogalusa, Fidelity & Casualty Company of New York v. Metropolitan Life Insurance Company and Pella Farmers Investment Insurance Company v. Hartland Richmond Town Insurance Company.

Respondent's reliance on the definition of the word "cooperative" as laid down in Presidential Decree No. 175 is misplaced. We are of the opinion that the word "cooperative" under said Decree has a separate and distinct meaning when compared to a cooperative company as defined in the Tax Code. The latter cannot be imagined to be composed of producers and consumers as what respondent would like us to think. Section 121 of the Tax Code deals on cooperative companies *doing insurance business* in the Philippines. Simple logic would tell us immediately that producers and consumers are never engaged in the insurance business. They have no privity with premiums or documentary stamp tax.

In the same vein, respondent opposes the exemption of petitioner from the payment of premium and documentary stamp taxes on the ground that it is not "operating under a lodge system" as specified in Section 199(1) of the Tax Code, *supra*.

Respondent is deliberately misleading this Court. A reading of said provision shows that a cooperative company "operated on the lodge system or local cooperation plan and organized and conducted solely by the members thereof for the exclusive benefit of each member and not for profit" is entitled to exemption. Respondent limited its discussion on the phrase "operated on the lodge system" only without touching on the more obvious and applicable alternative phrase "operated on.... local cooperation plan". Without qualms or quibbles, petitioner is operated on the basis of a local cooperation plan, it being a domestic cooperative company, as succinctly explained above, with an approved mutualization plan by the Securities and Exchange Commission.

WHEREFORE, in view of the foregoing premises, the instant Petition for Review is hereby **GRANTED**. Petitioner is exempted from the payment of premium and documentary stamp taxes. Accordingly, Assessment Notices in question, namely: **Nos. C-1-90-DST-075-95, C-1-91-DST-074-95, C-1-92-DST-073-95, C-1-93-DST-072-95, C-1-94-DST-071-95, C-1-93-Prem-077-65, C-1-94-Prem-076-95 and C-1-94-Prem-078-95** are hereby **CANCELLED** and declared as **INVALID** and **WITHOUT FORCE AND EFFECT**. No pronouncement as to costs.

SO ORDERED.

AMANCIO Q. SAGA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals