GREAT PACIFIC LIFE ASSURANCE CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 2342

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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# D E C I S I O N

The lone question tendered for resolution is whether "premiums or policy dividends" paid by a life insurance company to its policyholders are subject to the premium tax under Section 255 of the National Internal Revenue Code, which, insofar as it is pertinent hereto, reads:

> SEC. 255. <u>Taxes on insurance premiums</u>.- 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 three 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 receipts; x x x x.

Revenue Regulations No. 2, particularly Section 48, partly provides:

> x x x x Amounts received by an insured as a return of premiums paid by him under life insurannce, endowments, or annuity contracts, such as the so-called "dividends" of a mutual insurance company which may be credited against the current premium, are not subject to tax.

During the hearing of this case on July 27, 1977, counsel for petitioner Great Pacific Life Assurance Corporation manifested in open court that since the question involved herein is similar to one of the issues raised in the case of "The Philippine American Life Insurance Company vs. Commissioner of Internal Revenue," CTA Case No. 1689, November 12, 1973, certiorari denied, G.R. No. L-38292, March 8, 1974, he is submitting the case for decision on the basis of the pleadings and the records of the Bureau of Internal Revenue. No objection was interposed by counsel for respondent, and this case was therefore submitted to this Court for decision without trial on the merits.

As borne out by the pleadings submitted by the parties, particularly the petition for review filed by petitioner, and the records of the Bureau of Internal Revenue, it appears that:

1. Petitioner is a corporation duly organized and existing under and by virtue of the laws of the Philippines with offices and place of business at 221 Buendia Avenue, Makati, Rizal.

2. In a letter dated January 31, 1967, respondent assessed petitioner for the year 1963 the following deficiency taxes, inclusive of penalties:

35

a) Deficiency income tax . . . . . ₱13,807.55

b) Deficiency premium tax . . . . 1,593.18

In the same letter of January 31, 1967, respondent likewise demanded from petitioner the payment of the amount of ₱300.00 as extra-judicial compromise penalty for violation of Section 130 of Revenue Regulations No. 2. The said letter of respondent was allegedly received by petitioner on March 6, 1967.

3. In a letter dated March 8, 1967, and filed with the office of respondent on March 14, 1967, petitioner, through its auditors, protested the said assessment and asked for the reconsideration and cancellation thereof.

4. On October 7, 1971, petitioner, through its auditors, allegedly received respondent's letter dated September 9, 1971. In this letter, which constitutes respondent's decision on a disputed assessment, respondent decided to withdraw and cancel the assessment with respect to the deficiency income tax in the amount of ₱13,807.55. However, in the same letter-decision, respondent denied the request for the reconsideration of the deficiency premium tax assessment of ₱1,593.18 and of the compromise penalty in the amount of ₱300.00, and reiterated his demand for the payment of the said amounts.

Hence the present recourse.

36

The basis of the deficiency premium tax is the contention of respondent that the amount of ₱42,484.87 which was paid to petitioner's policyholders represented distribution of petitioner's accumulated earnings and not as mere return of premiums, hence, the said amount should have been included in the computation of the premium tax provided in Section 255 of the National Internal Revenue Code. Petitioner, on the other hand, avers that the true nature of such payments to policyholders, which in insurance parlance is known as 'dividends', is that they represent the return of the excess of the premiums paid by policyholders over what has been ascertained as the cost of their insurance protection, and under Section 255, <u>supra</u>, shall not be included in the taxable receipt for purposes of the 3% premium tax.

Indeed, as stated by counsel for petitioner when he submitted this case for decision on the basis of the pleadings and the records of the Bureau of Internal Revenue, and without objection on the part of respondent, the issue involved has already been decided in the case of "The Philippine American Life Insurance Company vs. Commissioner of Internal Revenue," <u>supra</u>. In the Philippine American Life Insurance Company case, where the factual setting is similar to that in the case at bar, this Court unequivocally sustained the stand of petitioner that dividends paid to policyholders are in reality return of excess premiums which were properly excluded from petitioner's taxable receipts for purposes of computing the premium tax. We quote from Philippine American Life Insurance Company:

The question presented 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 than 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. 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.

> 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 regarded as representing profits, it followed that, if the premiums were trebled, the profits would be increased in pro-

portion. (New York Life Ins. Co. v. Styles, 59 L.J.Q.B. 291, L.R. 14 App. Cas. 381 /1889/ cited in Mutual Benefit Life Ins. Co. v. Herold, 198 Fed. 199, aff'd Circuit Court of Appeals /3rd Cir./ 201 Fed. 918.)

The dividends herein paid have been apportioned and applied to the reduction of the premium named in the policy contract. In other words, what petitioner received was the difference between the stipulated premium and the so-called dividend. In such a case, the dividends are not sums paid to a policy holder and by him returned in cash. They are not income received (Mutual Benefit Life Ins. Co. v. Herold, *supra*). They are, therefore, not part of the "total premiums collected" but "premiums x x x returned for other reason to person insured xx x" excludable from the taxable receipts. (Sec. 255, *supra*.) It can make no difference in principle whether the surplus is applied to the reduction of premium or paid in hard cash. In either case the operation is in substance a return of part of premiums previously collected for which tax has already been paid. (Mutual Benefit Life Ins. Co. v. Harold, *supra*.) What petitioner receives by way of income and all that it is liable to be taxed for is the reduced premium.

> If, therefore, a policy holder by the express provision of his policy elects to have a previous overpayment of premium applied in reduction of a succeeding stipulated premium, what he pays and all that that he pays, or can be required to pay, is the reduced premium, and that is all that the company feceives by way of income, and all that it is liable to be taxed for. (Mutual Benefit Life Ins. Co. v. Herold, *supra.*)

It is urged that the dividends were taken from surplus and paid out to participating policy holders as dividends in the real sense. In resolving a similar argument, the Federal Court of the U.S. held:

> x x x . But it may be urged that the fund for which the so-called dividends are declared on mutual policies is likewise largely derived from interest on the company's investments, and that this shows that in a

real sense such dividends were, after all, declared from the earnings, profits, or income of the company. This proposition might be entitled to weight were it not for the fact that, in so far as the fund from which such dividends are declared is produced from interest on the company's invested funds, it has already been subjected to, and has paid, taxes under the act in question.

Furthermore, while perhaps not illegal, it is in a sense unfair, and therefore presumably contrary to the intention of Congress, as between a mutual company and a stock company, to tax the dividends in question as income received. The policy holder in a stock company pays a uniform and fixed premium each year. The premium in his case is not "loaded," but is presumed to represent cost as nearly as may be, for the reason that the stability of his policy is assured by the stock of the company, and not, as in the mutual plan, by premium payments avowedly in excess of the cost of the insurance. It would seem to be fair and equitable, therefore, between the two classes of companies, to tax them upon the premiums actually paid them by their policy holders, and not to tax one class upon premium payments actually received and the other upon payments which at the utmost are only "constructively received." (Mutual Benefit Life Ins. Co. v. Herold, supra.)

In view of the above, we are, therefore, of the opinion that the dividends paid to participating policy holders are in reality return of excess premiums which were properly excluded from petitioner's taxable receipts for purposes of computing the premium tax.

Accordingly, the assessment against petitioner Great Pacific Life Assurance Corporation for deficiency premium tax in the amount of

40

DECISION -
CTA CASE NO. 2342



₱1,593.18, inclusive of 25% surcharge, and the compromise penalty of ₱300.00, for the year 1963 cannot be sustained.

WHEREFORE, the decision appealed from should be as it is hereby reversed. No costs.

SO ORDERED.

Quezon City, August 22, 1977.

AMANTE FILLER
Acting Presiding Judge

I CONCUR:

CONSTANTE C. ROAQUIN
Associate Judge