REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

AFISCO INSURANCE CORPORATION,
CCC INSURANCE CORPORATION,
CHARTER INSURANCE CO., INC.,
CIBELES INSURANCE CORPORATION,
COMMONWEALTH INSURANCE COMPANY,
CONSOLIDATED INSURANCE CO., INC.,
DEVELOPMENT INSURANCE & SURETY CORPORATION,
DOMESTIC INSURANCE COMPANY OF THE PHILIPPINES,
EASTERN ASSURANCE & SURETY CORPORATION,
EMPIRE INSURANCE COMPANY,
EQUITABLE INSURANCE CORPORATION,
FEDERAL INSURANCE CO., INC.,
FGU INSURANCE CORPORATION,
FIDELITY & SURETY COMPANY OF THE PHILS., INC.,
FILIPINO MERCHANTS' INSURANCE CO., INC., 10/19/92
GOVERNMENT SERVICE INSURANCE SYSTEM,
MALAYAN INSURANCE CO., INC.,
MALAYAN ZURICH INSURANCE CO., INC.,
MERCANTILE INSURANCE CO., INC.,
METROPOLITAN INSURANCE COMPANY,
METRO-TAISHO INSURANCE CORPORATION,
NEW ZEALAND INSURANCE CO., LTD.,
PAN-MALAYAN INSURANCE CORPORATION,
PARAMOUNT INSURANCE CORPORATION,
PEOPLES' TRANS-EAST ASIA INSURANCE CORPORATION,
PERLA COMPANIA DE SEGUROS, INC.,
PHILIPPINE BRITISH ASSURANCE CO., INC.,
PHILIPPINES FIRST INSURANCE CO., INC.,
PIONEER INSURANCE & SURETY CORPORATION,
PIONEER INTERCONTINENTAL INSURANCE CORPORATION,

PROVIDENT INSURANCE COMPANY OF THE PHILIPPINES,
PYRAMID INSURANCE CO., INC.,
RELIANCE SURETY & INSURANCE COMPANY,
RIZAL SURETY & INSURANCE COMPANY,
SANPIRO INSURANCE CORPORATION,
SEABOARD-EASTERN INSURANCE CO., INC.,
SOLID GUARANTY, INC.,
SOUTH SEA SURETY & INSURANCE CO., INC.,
STATE BONDING & INSURANCE CO., INC.,
SUMMA INSURANCE CORPORATION,
TABACALERA INSURANCE CO., INC.,
assessed as "POOL OF MACHINERY INSURERS"

Petitioners,

- versus - C.T.A. CASE NO. 4039

THE COMMISSIONER OF INTERNAL REVENUE,

Respondent.

10/19/92

x - - - - - - - - - - - - - - - - - x

D E C I S I O N

Petitioners appeal the decision of the Commissioner of Internal Revenue assessing it deficiency income taxes and interest as a corporation, and withholding taxes as withholding agent on dividends paid to Munchener Ruckversicherungs-Gesselschaft of Munich (hereinafter referred to as Munich), a non-resident foreign insurance corporation.

The pertinent portion of respondent's decision is quoted:

> "xxx xxx xxx
>
> Records of this case disclosed that Pool is a non-stock, non-profit corporation engaged in the insurance business; that this Office has considered Pool as a corporation subject to tax under Section 24 of the Tax Code; that for the year 1975, Pool derived premium income of P9,701,169.00 and commission income of P572,576.00 constituting a total underwriting income of P10,273,745.00; that after deducting the total underwriting deductions of P6,823,936 and operating expense of P21,332.00 there remains a net income from operations in the amount of P3,239,477.00; and that adding other income amounting to P497,893.00, the total taxable income of Pool is P3,737,370.00, which is subject to income tax in the amount of P1,843,273.60. Your allegation that the income represents reinsurance premiums which is not subject to income tax cannot be sustained since there is no proof on record supporting your allegation.
>
> For the same reason this Office also sustains the assessment of P1,768,799.39 as deficiency withholding tax assessed against your client.
>
> As regards the assessment of P89,438.68 as deficiency withholding tax on dividends paid to Pool members, the same is also sustained. It clearly appears on record that your client distributed dividends to Pool members which are subject to the 10% withholding tax.
>
> Finally, the right of the government to assess Pool is not barred by the statute of limitations considering that it did not file an income tax return but merely an information return. In other words, assessment can be made within ten (10) years from discovery of the failure to file income tax return, pursuant to Section 319 of the

Tax Code. In this case the discovery was made on February 27, 1981 which is the date of the report of the investgating examiners, and the assessment as made on March 27, 1981.

xxx xxx xxx."

The assessment against petitioners is itemized as follows:

Net income per information return	P3,737,370.00
Income tax due thereon	P1,298,080.00
Add: 14% Int. fr. 4/15/76 to 4/15/79	545,193.60
TOTAL AMOUNT DUE & COLLECTIBLE	P1,843,273.60
Dividend paid to Munich Reinsurance Company	P3,728,412.00
35% withholding tax at source due thereon	P1,304,944.20
Add: 25% surcharge	326,236.05
14% interest from 1/25/76 to 1/25/79	137,019.14
Compromise penalty- non-filing of return	300.00
late payment	300.00
TOTAL AMOUNT DUE & COLLECTIBLE	P1,768,799.39
Dividend paid to Pool Members	P 655,636.00
10% withholding tax at source due thereon	P 65,563.60
Add: 25% surcharge	16,390.90
14% interest from 1/25/76 to 1/25/79	6,884.18
Compromise penalty - non-filing of return	300.00
late payment	300.00
TOTAL AMOUNT DUE & COLLECTIBLE	P 89,438.68

Petitioners are non-life insurance corporations organized and existing by virtue of the law of the Philippines which entered into Erection, Machinery Breakdown, Boiler Explosion and Contractors' All Risks Reinsurance Treaties. The

Reinsurance Treaties provided for the creation of a Pool known as "Pool of Machinery Insurers".

Petitioners dispute the decision of respondent by contending, among others, that the so-called "Pool of Machinery Insurers" is not a corporation within the meaning of Section 24 of the National Internal Revenue Code (Commonwealth Act 466, as amended among others by Presidential Decree 69). Said Pool was never engaged in any business least of all the insurance business whether as insurers, reinsurers, or in the assumption of any risk as insurer. It allegedly merely served as a "clearing house" for the Pool members, and trustee of the funds (through an Executive Board) of the Pool signatories and of the unremitted premiums due to Munich on reinsurance ceded and assumed by Munich. Assuming the Pool can be termed a corporation as provided in Section 84 of the National Internal Revenue Code, it is nevertheless tax-exempt under Section 27(f) of the same. There is, further, petitioners proposition that respondent's assessment is barred by prescription.

The respondent asserts that petitioners compose a partnership as defined in Article 1767 of the Civil Code in relation to Section 20 (b) of the National Internal Revenue Code (of 1977).

After referring to the evidence submitted and cases that shed light on the subject of what and what does not constitute a corporation, we take the opinion that the findings of respondent are sustainable.

As further described in Section 84(b) of the National Internal Revenue Code a "corporation" for income tax purposes includes associations or partnerships no matter how created or organized. The essential elements of a "partnership" relation have been laid as 1) purpose to engage in some business enterprise; 2) joint control or management of such business (Bautista, Philippine Partnership Law, p. 3 citing cases). An "association", generally, may exist where individuals voluntarily have associated themselves together, without a charter or in unincorporated form, to engage in business, using methods and forms resembling those commonly used by corporations (Mertens, Law on Federal Income Taxation, Vol.7, 1976 revision, Chap. 38A p. 2). An association and a partnership are so similar in many instances that it is almost impossible to distinguish one from the other (*Id.*). More so under Philippine law as the tax implications of an association and a partnership treated as a corporation are the same.

For taxation purposes, emphasis is not on the form but on the substance of the entity and its transactions (Mertens, *supra* citing National Investors Corp. v. Hoey 144 F 2d 466). A "corporation" will be interpreted to mean a corporation which does some "business" in the ordinary meaning of the term (*Id.*). Some commercial, industrial or other activity is doing "business" in the ordinary meaning (*Id.*). "It would seem that the term "business" implies the profit motive (Bautista, *supra*). The determination of the existence of a corporate entity for tax purposes necessitates, therefore, inquiry mainly into whether the entity served a business purpose (Mertens, *supra* Chap. 38A, citing cases). The element of joint control or centralized management has also been established as essential as well as continuity of life of the organization. (Mertens, *supra*, p. 8 citing Estate of Smith v. Comm., 313 F 2d 724; See also Chap. 38A, pp. 13-14).

In refusing to acknowledge its character as a corporation, petitioners deny any premium income, the issuance of any insurance policies, or the assumption of any risk of loss. The evidence perused belie the contention of petitioners that the Pool does not assume any risk. The ceding to

Munich of only a part of the insurances previously underwritten by the "Ceding Companies" which comprise the Pool would connote proportionate sharing of risks between them. The Quota Share Reinsurance Treaty for example provides that "The Ceding Companies' undertake to cede to the 'Munich' a fixed quota share of 40% of all insurances mentioned in Article 2 thereof and 'Munich' shall be obliged to accept all insurances so ceded (Article 3). The Surplus Reinsurance Treaty, on the other, provides that "The 'Ceding Companies' bind themselves to cede to the 'Munich' the entire 15 line surplus of the insurance specified in Article 2 hereof. The surplus shall consist of all sums insured remaining after deduction of the Quota share and of the proportion combined net retention of the 'Pool'. The retention referred to applies to the sum insured of each machine, mechanical equipment or apparatus, in case of erection insurance to each object insured (See Table of Retention, Exh. "M", p. 2). The 'Munich' undertakes to accept the amounts so ceded up to fifteen times the 'Ceding Company's proportionate retention (Article 3)". While it is understood that we have Reinsurance Treaties here between the Ceding Companies and Munich, the latter, from our understanding of the provisions of the agreement and its supplements, did not undertake to assume all of the risks of the other as ordinarily a reinsurance contract would apply (See definition of "reinsurance" 36 Words and Phrases 730-731). Instead the Pool was created with one of the purposes as a sharing of risks with Munich, as in fact, only a part of the insurances have been ceded to Munich. The Pool members were clearly left with some share of assumption of risks as the following other provisions would imply:

1. In the case of a loss where the members are requested to advance their share of the loss immediately, the Executive Board shall advise the members of the amount of contribution of each for the loss and, if the free funds to the credit of a member in the Pool are insufficient to cover the loss, the Executive Board shall request the member to forward immediately to it the necessary amount for payment to the Ceding Company of the share of the Pool members in the loss (Article V, Sec. IV of the Pool Agreement).

   a. The parties to this Agreement have agreed to create a reserve fund, in an amount to be decided from time to time by the Executive Board, to guarantee the prompt settlement of losses. The Pool shall deposit the funds in a Savings Account bearing interest at the prevailing rate, and any interest earned shall be credited to the account of each member company in proportion to its contribution to the reserve fund. It is understood and agreed, however, that any member-company withdrawing from the Pool shall have the right to withdraw its share of the reserve fund including

> earned interest, if any, after meeting all its obligation (Addendum No. 1 to the Pool Agreement).
>
> The reserve fund shall be used exclusively for the settlement of the share of a loss due from the member-company who has failed to respond to a cash call within the prescribed period and only to the extent of the respective contributions to the fund of said members, in such a way that the contribution of one member shall not answer for the loss settlement liability of another or other members. Finally, it is understood and agreed that any loss payment made out of the reserve fund for the account of any member-company shall be replenished by each member concerned within thirty (30) days from cash call (*Id.*).
>
> 2. The liability of the 'Munich' for the reinsurances ceded to it under this Agreement shall commence and cease simultaneously with that of the 'Ceding Companies' (Article 6 of the Quota Reinsurance Treaty).
>
> It is understood and agreed that the 'Munich' shall follow the fortunes of the'Ceding Companies' in treaty matters in the proportion of its share (*Id.*, See similar provision in the Surplus Reinsurance Treaty).

There being a cession of insurances from the Ceding Companies to Munich and a sharing of risks by the Pool, income is earned by the Ceding Companies in the form of premiums and various types of commissions paid to it by Munich.

This is illustrated by different provisions in the Agreement and its supplements, viz:

a. The parties to this Agreement shall share in the business ceded to the Pool in accordance with the 'Rules for Distribution', xxx (Article V, Section VII of the Pool Agreement).

b. "Divide the premium of a given policy into 60%-40% shares; 40% to be ceded to the "Munich" through the Quota Share Treaty and 60% to the Pool members in equal sares" ("Rules of Distribution", par. 1).

Debit 'Munich' with 40% of the Commission paid by the ceding company on the full premium and 40% of 5% of the full premium as general expense of the ceding company. Debit the Pool members on the amount retained, with the commission paid by the ceding company and 5% for general expenses. These amounts to be credited to the ceding company ("Rules of Distribution", par. 2).

Credit the ceding company with 30% reinsurance commission on any surplus placed with 'Munich' under Surplus Treaty, debiting 'Munich' with the total reinsurance commission ("Rules of Distribution", par. 3).

c. The 'Munich's' share shall be ceded in original currency on the same terms and conditions as the original insurances (Article 5, Surplus Reinsurance Treaty).

The 'Munich' shall pay to the 'Ceding Companies' a fixed commission of 30% in respect of the business ceded under this Agreement and the obligatory cessions mentioned in Article 4 above (*Id.*).

For the business accepted by the'Ceding Companies' from the G.S.I.S. by way of reinsurance the 'Munich' shall pay its proportionate part of the commissions granted to the G.S.I.S., viz 35% for the Quota Share and 30% for the Surplus and 15% profit commission on the combined results of the Quota Share and Surplus Treaties (*Id.*).

In addition, the 'Munich' shall pay the 'Ceding Companies' on all premiums ceded to it under this Agreement, until December 31, 1967, special commission of 5%, or the actual expense ration of the Pool (Pool total costs in relation to Pool total premium income), whichever is less (*Id.*).

Furthermore, the 'Munich' shall pay the 'Ceding Companies' a profit commission of 20% on the net profit derived from this Agreement and computed as follows:

INCOME

1. Premiums of the current year less cancellations;

2. Reserve for outstanding losses from previous year,

3. 40% unexpired risk reserve from previous year.

OUTGO

1. Losses paid during the current year;

2. Reserve for losses outstanding at the end of the current year;

3. 40% premium reserve for preiums unearned at the end of the current year;

4. Reinsurance commission, special commissions and profit commission according to the first five paragraphsof this Article;

5. Management expenses of the'Munich' being 5% of Item 1) of 'Income';

6. A loss, if any, from previous year(s) to be carried forward until extinction (*Id.*).

The 'Ceding Companies' shall make up combined Profit Commission Statements for this Agreement and the Quota Share

> Reinsurance Treaty made with 'Munich' (*Id.*).
>
> In the event of this Agreement being terminated the final profit commission statement shall be made up after the 'Munich' has discharged all its liabilities (*Id.*).

But petitioners would insist that these provisions instead prove that the Pool members themselves may earn profit or income but petitioners' Pool itself earns no profit or income. It is urged that the Pool is merely a clearing house as defined in Section 31 of the Revenue Regulations No. 2 since all the premiums are received only in a custodial capacity and eventually distributed to the Pool members.

We are more impressed, however by the presence of the indispensable elements of a "partnership" in the Pool. What forms the common fund are the portions of the premiums of insurance policies and commissions ceded to the Pool. This fund is managed by an Executive Board. It is not as simple as this though for if it were merely so, the arguments of petitioners would have force. It does not turn out that the shares of the Pool members are distributed to them equally or proportionately immediately. Petitioners, as it appears, composed themselves into a Central Body acting through the

Executive Board "to put into effect the requirements of the Quota and Surplus Share Treaties". The "partnership" element of joint control or management stresses the character of the Pool as corporation here. The Executive Board possesses these powers and functions:

1. To carry on to the best advantage and interest of the Pool the duties of distributing the business received between the members and "Munich" and to make, execute, sign, seal and deliver for each of us all instruments or documents in writing of whatever kind or nature which shall be necessary to the proper conduct of said business;

2. To deposit funds of the Pool and to withdraw the same by check, receipt, draft or otherwise and to transact any and all business operations and affairs with any and all banking institutions may be deemed necessary, proper and convenient by our said attorney-in-fact;

3. To demand, collect and receive from "Munich" any and all sums of money which are now or may hereafter become due us by reason of the above reinsurance treaties between the members of the Pool and the "Munich"; with full power and authority to execute and deliver in our behalf full acquittances and receipts for all payments made to them in our behalf;

4. To settle all questions of payment or premiums or losses between the members of the Pool and the "Munich" in accordance with the terms and conditions of the Treaties;

> 5. In the event of loss, to pay off our share of said loss in our behalf from whatever funds we may have with the Pool.

In short, the Executive Board has such powers as ordinarily a corporate board of directors may have, if not some powers which such boards do not have. And the expenses for this Central Office are shouldered by all the Pool Members (Par. 5, Rules of Distribution, Exh. K-3).

Further, since there is assumption of risk by all the Pool Members, a reserve fund was created "to guarantee the prompt settlement of losses" (Exh. K-2). "The reserve fund shall be used exclusively for the settlement of the share of a loss due from the member-company who has failed to respond to a cash call within the prescribed period." The profits are distributed only after the business of insurance has been transacted and after all losses and expenses of management have been paid from the common fund.

As another point, there is continuity of life of the organization if the "withdrawal or expulsion" of any member will not cause a dissolution of the organization (Mertens, Chap. 38A- p.14 citing cases). This character generally seen in a corporation is also apparent in the Pool considering the provision in Section 1, Article VI on membership which provides:

> "Should the conduct or action of any member of the Pool be considered unethical or against the reputation or interests of the Pool by the Central Body, at a meeting called to discuss the matter, upon concurrence of at least two-thirds (2/3) of all the members of the Pool, this Pool Agreement may be rescinded as far as the erring member is concerned and formal notice of such rescission shall be given by the Pool to 'Munich'."

Addendum No. 2 to the Pool Agreement in Section 1, Art. VI thereof also states in part:

> "xxx If the license of a member should be revoked or suspended, such member shall from the date the license is revoked or suspended, automatically cease to be a member of the Pool. xxx."

These conditions no doubt form an entity akin to a corporation carrying on a business purpose. We are satisfied that this concern falls fairly within the context of a "corporation" as defined. The fact that the Pool does not retain any profit or income does not obliterate an antecedent fact, that of the Pool being used in the transaction of business for profit. It is apparent, and petitioners admit, that their association or coaction was indispensable in the transaction of the business. In their words, the establishment of a pool "is dictated by the need for said insurance companies to pool their resources together if they expect to capture some insurance business". If together they have conducted business, profit must have been the object as, indeed, profit was earned. Though the profit was apportioned among the members, this is only a matter of consequence, as it implies that profit actually resulted.

What has been said above can likewise be applied for the other items in issue. The withholding tax at source on alleged dividends to the foreign corporation, Munich, is sustainable. Withholding of taxes as pointed out in the related provisions, Sections 24(b), 53(b)(2), and 263 is not required in case of reinsurance premiums ceded to foreign insurance corporations. What is being taxed here, however, are not reinsurance premiums but surplus profits, for simply, dividends are but such.

As had been said, reinsurance premiums in their pure form were not received by Munich. Under the Quota Reinsurance Treaty and the Surplus Reinsurance Treaty the premiums are subject to deductions for expenses, costs, commissions payable to the Ceding Companies, and Munich's proportionate share in any loss. To this effect, there is an agreement that the expenses of the Central Office shall be borne 40% by Munich and 60% by the Pool (Paragraph 5, Rules of Distribution). Under Article II, both of the Quota and Surplus Reinsurance Treaties, the Pool is obliged to render quarter statements of accounts, showing all premiums, original costs, losses, commissions taken into account. In settling the accounts, a premium reserve (40% of the net reinsurance premiums (reinsurance premiums ceded less cancellations) retained as per Quota Reinsurance Treaty, Article 12; and 50% of the net reinsurance premiums as per surplus Reinsurance Treaty, Article 12) shall be taken into consideration. Incidentally, the Pool is obliged to pay interest on the premium reserve at two percent per annum to Munich.

The tax of P89,438.68, on the other hand is a 10% withholding tax on dividends paid to Pool members. The explanation being proposed by petitioners would not matter now in the face of the above conclusions arrived at by the Court.

We now pass upon the issue of prescription.

Petitioners in this case assert that the Pool filed information return of exempt organization on April 14, 1976 and it was not until November 11, 1981 that they became aware of the assessment notice and demand dated March 27, 1981. Reckoning therefore, the period from April 14, 1981 the date of filing the information return, more than five years had elapsed. They therefore argued that prescription has set in pursuant to the provision of the National Internal Revenue Code.

We find this argument unavailing to petitioners because the taxpayer cannot be located at the address given in the information return filed and for which reason there was delay in sending the assessment. It must be stressed that this is one of the instances which suspends the running of the prescriptive period set forth by then Section 333 of the National Internal Revenue Code as amended by P.D. No. 69, which in part pertinent reads:

> "Sec. 333. Suspension of running of statute. - The running of the statute of limitations provided in Section 331 or 332 on the making of assessment and the beginning of distraint or levy or a proceeding in court for collection, in respect of any deficiency, shall be suspended for the period during which the Commissioner of Internal Revenue is prohibited from making the assessment or beginning distraint or levy or a proceeding in court, and for sixty days thereafter; xxx; when the taxpayer cannot be located in the address given by him in the return filed upon which a tax is being assessed or collected; xxx." (Underscoring supplied)

On this basis, respondent is not barred from assessing and collecting the taxes due from the Pool.

WHEREFORE, the Petition for Review is denied as the decision of the Commissioner of Internal Revenue is **SUSTAINED**.

SO ORDERED.

Quezon City, Metro Manila, October 19, 1992.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

MANUEL K. GRUBA
Associate Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

I hereby certify that this decision was reached after due consultation among 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