Michigan Law Review

Volume 40 | Issue 3

1942

# TAXATION - INSURANCE COMPANIES - CONSIDERATIONS FOR ANNUITY CONTRACTS AS "PREMIUMS" RECEIVED FOR INSURANCE CONTRACTS

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TAXATION — INSURANCE COMPANIES — CONSIDERATIONS FOR ANNUITY CONTRACTS AS "PREMIUMS" RECEIVED FOR INSURANCE CONTRACTS — The defendant commissioner of insurance refused to issue to plaintiff insurance company a certificate of authority to do business in Kansas unless plaintiff paid back taxes claimed to be due on considerations received for "annuity contracts" [1] by the plaintiff, in Kansas, between 1927 and 1938 inclusive. The tax in question was "upon all premiums" received during the year, but the plaintiff contended the word "premiums" did not include considerations received for "annuity contracts." Plaintiff brought mandamus to compel defendant commissioner to issue a certificate of authority to do business. *Held,* three judges dissenting, that the word "premiums" included considerations received for "annuity contracts" and the certificate had been properly withheld.[2] *Equitable Life Assurance Society of United States v. Hobbs,* 154 Kan. 1, 114 P. (2d) 871 (1941).

As a result of the present decision and a similar one in a recent Missouri

[1] Of the three kinds of "annuity contracts" involved, immediate life annuities, deferred life annuities, and survivorship annuities, only the first two were in question since the plaintiff company admitted the third type was essentially life insurance. The commissioner had made no request for taxes on the considerations received for such "annuity contracts" until 1936 and there was no provision for reporting such receipts on the annual reporting form furnished by the commissioner to the company.

[2] The judge writing the majority opinion also wrote the dissenting one in which two other of the seven judges concurred.

case,[3] the authorities precisely in point are now almost evenly divided,[4] although formerly the clear weight of authority was opposed to the majority opinion in the principal case.[5] The Pennsylvania[6] and New York[7] courts in the two leading cases took a definitional approach based on the proposition that there is

[3] State ex rel. Aetna Life Ins. Co. v. Lucas, (Mo. 1941) 153 S. W. (2d) 10. The statute involved was a tax on "premiums received" for "business done" in the state. All the judges concurred in saying there was no ambiguity in the statute and, therefore, the cases cited by plaintiff insurance company (those cited in note 4, infra) were not in point. This would seem to be assuming the very question to be decided for the cases were definitely in point, as is recognized by the majority opinion in the Kansas case. The Missouri court made no mention of the fact that their tax was for "business done," a distinction used by many courts. See Northwestern Mut. Life Ins. Co. v. Murphy, 223 Iowa 333, 271 N. W. 899 (1937), and the minority opinion in the principal case.

[4] That annuity contract considerations are not included in "premiums" received: Commonweath v. Metropolitan Life Ins. Co., 254 Pa. 510, 98 A. 1072 (1916); People ex rel. Metropolitan Life Ins. Co. v. Knapp, 193 App. Div. 413, 184 N. Y. S. 345 (1920), affd. 231 N. Y. 630, 132 N. E. 916 (1921); Daniel v. Life Ins. Co. of Virginia, (Tex. Civ. App. 1937) 102 S. W. (2d) 256; State v. Equitable Life Assur. Soc., 68 N. D. 641, 282 N. W. 411 (1938); and State ex rel. Equitable Life Assur. Soc. v. Ham, 54 Wyo. 148, 88 P. (2d) 484 (1939). That annuity contract considerations are included in "premiums" received, in addition to the Missouri and principal cases: State ex rel. Attorney General v. New York Life Ins. Co., 198 Ark. 820, 131 S. W. (2d) 639 (1939); State ex rel. Gully v. Mutual Life Ins. Co., 189 Miss. 830, 196 So. 796, 198 So. 763 (1940) (no attempt made to distinguish on basis of a tax for "business done"). There are three other cases cited by the majority opinion in the Kansas case for including annuity considerations, also relied on by the Mississippi and Arkansas courts: Mutual Benefit Life Ins. Co. v. Commonwealth, 227 Mass. 63, 116 N. E. 469 (1917); Northwestern Mutual Life Ins. Co. v. Murphy, 223 Iowa 333, 271 N. W. 899 (1937); and New York Life Ins. Co. v. Sullivan, 89 N. H. 21, 192 A. 297 (1937). The first two were distinguished by the minority opinion in the principal case (and by the courts of North Dakota and Wyoming) on the ground that the tax was for "business done" as compared with "on premiums received" in the principal case. The New Hampshire case was distinguished on the ground of the peculiar history of the legislation in point in that state. See also Hogg, "Taxation of Life Insurance Companies under State Laws," 17 TAX MAG. 73 (1939). It might be questioned whether the distinction pointed out in the first two is really valid since the legislatures probably meant to tax the same receipts; nevertheless, it has been accepted by some courts.

[5] One writer as late as April, 1941, said, "the majority of cases [reached] the conclusion that the particular tax is limited to life insurance premiums under ordinary types of life insurance." Meisenholder, "Taxation of Annuity Contracts under Estate and Inheritance Taxes," 39 MICH. L. REV. 856 at 864, note 20 (1941). An assistant counsel for the Association of Life Insurance Presidents writes in the same vein, "the authorities support the general proposition that a statute taxing premiums does not reach annuity considerations merely because such contracts are written as part of the business of a life insurance company." Hogg, "Taxation of Life Insurance Companies under State Laws," 17 TAX MAG. 73 at 74 (1939).

[6] Commonwealth v. Metropolitan Life Ins. Co., 254 Pa. 510, 98 A. 1072 (1916).

[7] People ex rel. Metropolitan Life Ins. Co. v. Knapp, 193 App. Div. 413, 184 N. Y. S. 345 (1920), affd. 231 N. Y. 630, 132 N. E. 916 (1921).

a fundamental distinction between annuity contracts and insurance policies, especially life insurance policies. To support this distinction the two courts relied on lexicographical and case definitions of "insurance," [8] on cases involving different problems but which held there was a distinction,[9] and on opinions of various text writers.[10] All these authorities based their distinction on the difference between the fundamental purpose of ordinary insurance policies and that of annuity contracts.[11] The New York and Pennsylvania courts also relied on the statutory language in other sections of the insurance laws as indicative of a legislative intention to recognize the existence of both insurance contracts and annuity contracts, and not to treat insurance contracts as one general class

[8] Though the particular language used differs somewhat, all seem to define "insurance" in terms of "indemnity" "for risk" of "loss" from a "specified peril" or the "happening of a particular event," or to "compensate for loss on a specified subject." The courts then reason there is no contemplated loss from a specific event, so annuity contracts are not insurance contracts. The definitional approach is particularly subject to this fallacy. For examples of these definitions, see: WORDS AND PHRASES, perm. ed. (1940); Chicago Bonding & Ins. Co. v. Oliner, 139 Md. 408, 115 A. 592 (1921); People ex rel. Kasson v. Rose, 174 Ill. 310, 51 N. E. 246 (1898).

[9] Annuity contracts are held not to be insurance in various situations. Statutes requiring certain formalities before issuing insurance contracts: Rishel v. Pacific Mut. Life Ins. Co., (C. C. A. 10th, 1935) 78 F. (2d) 881; Hall v. Metropolitan Life Ins. Co., 146 Ore. 32, 28 P. (2d) 875 (1934); Curtis v. New York Life Ins. Co., 217 Mass. 47, 104 N. E. 553 (1913). Insurance exemptions in estate and inheritance taxes: Old Colony Trust Co. v. Commissioner of Internal Revenue, (C. C. A. 1st, 1939) 102 F. (2d) 380; Helvering v. Le Gierse, 312 U. S. 531, 61 S. Ct. 646 (1941); Matter of Sothern's Estate, 170 Misc. 805, 14 N. Y. S. (2d) 509 (1938), affd. 257 App. Div. 574, 14 N. Y. S. (2d) 1 (1939); State ex rel. Thornton v. Probate Court, 186 Minn. 351, 243 N. W. 389 (1932); Guaranty Trust Co. of New York, 16 B. T. A. 314 (1929). Bankruptcy laws exempting insurance: In re Power, (C. C. A. 7th, 1940) 115 F. (2d) 69; In re Walsh, (D. C. Minn. 1937) 19 F. Supp. 567. Illegal issuance on mutual plan if insurance: Carroll v. Equitable Life Assur. Soc., (D. C. Mo. 1934) 9 F. Supp. 223. Assignment requirements for insurance contracts: In re National Provincial Life Assurance Society, L. R. 9 Eq. 306 (1870). Insurance exemptions from property tax: Bowman v. Tax Commission of Ohio, 135 Ohio St. 295, 20 N. E. (2d) 916 (1939). Language to the effect that annuities are not insurance: Cuthbert v. North American Life Assur. Co., 24 Ont. Rep. 511 (1894); Wellman v. Board of Commissioners of Jewell County, 122 Kan. 229, 252 P. 193 (1927). See also: 63 A. L. R. 711 at 719 (1929); 109 A. L. R. 1060 (1937); 38 MICH. L. REV. 526 at 530, note 11 (1940).

[10] HARWOOD and FRANCIS, INSURANCE AND ANNUITIES FROM THE BUYER'S POINT OF VIEW (1935). The statement is made, p. 120, that annuity contracts are the "reverse" of insurance policies. Yet, p. 117, we find one type of annuity contract referred to as a "Single *Premium*" annuity. Similar uses of "premium" are to be found throughout the text. HUEBNER, LIFE INSURANCE, 3d ed., (1935), devotes a whole chapter to the fundamental difference between annuity and life insurance contracts, yet reminds us, p. 184, that they are essentially insurance contracts. See also: 3 C. J. 202, note 17 (1915); 3 C. J. S. 1375-1376 (1936).

[11] The difference relied on by all these authorities is that an "annuity" is designed to "liquidate an existing fund," a form of *investment*, while "insurance" is to "create" a fund, a form of *indemnity*. One is a provision for life, while the other is for death.

inclusive of both types.[12] These courts then pointed out that the word "premiums" is commonly used to indicate receipts from ordinary insurance policies and not from annuity contracts, a more doubtful proposition than the first, though based on substantial authority.[13] They, therefore, concluded that the legislature could not have intended to include such receipts in a tax on "premiums." The fallacy in this technical reasoning is that it ignores the question of the actual intent of the legislature, which is the real problem involved. Did the legislature mean "premiums" to include considerations received from annuity contracts or was the word used in the technical sense applied by the Pennsylvania and New York courts?[14] It is submitted that the view of what was really a majority[15] of the judges in the leading New York case is the sounder conclusion as to the legislative intent at that time.[16] These judges took the position that the tax was imposed for the privilege of "doing business" in the state, and they could see no reason why the legislature would exempt considerations received for annuities, especially since no word other than "premiums" had been used to describe considerations received for such annuities.[17] It is reasonable to say that the Pennsylvania and New York legislatures thought of annuities as insurance contracts, and receipts therefrom as "premiums," since such contracts are almost invariably issued by insurance companies, usually by express legislative permission, and involve the same fundamental idea of "spreading the risk" on the basis of actuarial tables.[18] On the other hand, there are reasons why the principal case might quite properly have followed the view adopted by its three dissenting judges. When the particular statute[19] was enacted in 1927, the situation was somewhat different from that at the time of the New

[12] Such as Kan. Gen. Stat. Ann. (1935), § 40-401, "to make insurance . . . *and to grant . . . annuities.*" (Italics added.) The courts conclude that this is superfluous language unless the two are different kinds of contracts.

[13] See 3 C. J. S. 1375-1376 (1936); Carroll v. Equitable Life Assur. Soc., (D. C. Mo. 1934) 9 F. Supp. 223 at 224; BOUVIER, LAW DICTIONARY, 8th ed. (1914); THE NEW CENTURY DICTIONARY (1929); and WEBSTER, NEW INTERNATIONAL DICTIONARY, 2d ed. (1935), for definitions of "premium" which are based on the usual definition of "insurance." See also note 8, supra; and Hogg, "Taxation of Life Insurance Companies under State Laws," 17 TAX MAG. 73 (1939).

[14] The dissenting opinion in the principal case, though it accepts the reasoning of the New York and Pennsylvania cases, recognizes that the intent of the Kansas legislature is the controlling question.

[15] Actually only two judges in the Appellate Division accepted the definitional approach, the third judge concurring on different grounds but agreeing with the two dissenting judges that the legislature meant the word "premiums" to include annuity considerations. The Court of Appeals affirmed without opinion, one judge dissenting.

[16] The concurring judge pointed out that even the insurance companies had treated the tax as including considerations for annuity contracts for several years before the objection was first made.

[17] These judges, like the majority judges, in supporting their view, could point to certain statutory language to support this view that the legislature intended to make no distinction. They also pointed out that the annuity contracts themselves used the word "premium."

[18] HUEBNER, LIFE INSURANCE, 3d ed., 184 (1935), discusses these essentially insurance characteristics of annuity contracts.

[19] Kan. Gen. Stat. Ann. (1935), § 40-252.

York and Pennsylvania cases, for in 1927 there was definite case authority to support the technical definition of "premiums," [20] a definition which had been accepted by various insurance commissioners [21] and upon which the insurance companies had relied in establishing the cost of annuity contracts.[22] In the light of these authoritative opinions, available to the legislature when the statute was passed, it may well be argued that it is at least doubtful what the legislature meant by "premiums." [23] If a reasonable doubt exists, all the authorities agree that it is to be resolved in favor of the taxpayer.[24] It might be argued that the small number of annuity contracts in 1927 as compared with those in the depression years [25] indicates the Kansas legislature was not thinking of annuities in taxing "premiums," though this is of doubtful significance. It has been argued, too, that since it would be so easy to add "and considerations for annuity contracts" the legislature must not have intended to include them. This would seem to be an indication that the legislature never thought of the problem rather than an indication of an intent not to include. Policy, though, may require a different basis of taxation, since the fundamental purposes of the two types of contracts are different.[26] The better solution of this problem [27] as to the legislative intent is

[20] Commonwealth v. Metropolitan Life Ins. Co., 254 Pa. 510, 98 A. 1072 (1916); People ex rel. Metropolitan Life Ins. Co. v. Knapp, 193 App. Div. 413, 184 N. Y. S. 345 (1920), aff. 231 N. Y. 630, 132 N. E. 916 (1921).

[21] The insurance commissioner of Mississippi (case cited note 4, supra) had so interpreted the law and probably the Kansas commissioner thought likewise as pointed out in the dissenting opinion.

[22] State ex rel. Aetna Life Ins. Co. v. Lucas, (Mo. 1941) 153 S. W. (2d) 10, points out that actually the same price was charged in Missouri as was charged in states where it paid taxes on annuity considerations. There may possibly have been other explanations.

[23] This language has not been changed by subsequent Kansas statutes, though the question was raised by the insurance commissioner in 1936. The Wyoming legislature, upon the question being raised, promptly passed a statute expressly taxing considerations for annuity contracts before the court even decided the case. Mentioned in State ex rel. Equitable Life Assur. Soc. v. Ham, 54 Wyo. 148, 88 P. (2d) 484 (1939). The New York legislature on the other hand has expressly recognized and preserved the distinction. See note 26, infra. There is no doubt, of course, as to the *power* of the legislature to levy such a tax. An interesting discussion of whether or not as a matter of policy such taxes on insurance contracts should be levied is found in Todd, "The Taxation of Life Insurance Companies," 12 TAX MAG. 223 at 225 (1934).

[24] Both the majority and minority opinions in the principal case accept this. For some of the innumerable cases establishing this rule, see 59 C. J. 1131-1133 (1932), particularly note 86 (g). On the other hand, the general purpose of the statute is to be given a reasonable interpretation and not be defeated by mere technical refinements. 59 C. J. 1132-1135 (1932); 2 COOLEY, TAXATION, 4th ed., 1130 (1924).

[25] There was a surprisingly rapid increase in the number of annuity contracts made by the insurance companies in the recent depression years, 38 MICH. L. REV. 526, note 3 (1940).

[26] The New York Insurance Code enacted in 1939 specifically exempts considerations received for annuity contracts from the definition of "premiums." 27 N. Y. Consol. Laws (McKinney, 1940), § 550 (1).

[27] The tremendous importance to insurance companies of the recent trend of the courts to include annuity considerations as "premiums" is indicated by the fact that

for the legislatures to provide specifically for inclusion or exemption, but until such is done, in view of the doubt and consequent hardship on the insurance companies in determining costs, courts might very reasonably follow the minority opinion in the principal case.

practically every state has a similar tax which may mean payment of huge sums in back taxes in the vast majority of states which have not as yet decided the question. Two very complete compilations of the "premiums" taxes imposed by the various states, found in Snyder, "Taxation of Insurance Companies by the States," 16 TAX MAG. 335 at 374 (1938), and Hogg, "Taxation of Life Insurance Companies under State Laws," 17 TAX MAG. 73 at 74 (1939), indicate that all but two or three states have some sort of "premium" tax which may give rise to the question here involved. Information received from the Attorney General's office indicated that as much as $600,000 may be collected from the plaintiff and 26 other insurance companies which agreed to abide by the present decision. Multiply this by the possible thirty or more states which have not as yet decided the question and a staggering potential liability is placed on these insurance companies. The considerations have already been set and usually collected for the contracts on which these taxes will be assessed so it must come out of some reserve fund or be added to the cost of annuities issued to future customers. The hardship of this reliance by the companies on the interpretation given "premium" by the insurance commissioners and others may be alleviated in the present case since the court expressly reserved the question of liability for the *back* taxes not paid. This is not certain by any means though, and does not answer the question of what the intent of the legislature was in 1927. It is significant to note that of the 12 cases in point (note 4, supra) all but three have been decided since 1937, indicative of the rising importance of the problem.