INSURANCE: 2% gross premium tax on life insurance companies cannot be collected when company is no longer licensed even though some business remains in force.

August 17, 1940

8-27

FILED
55

Honorable Ray B. Lucas, Sup't.
Department of Insurance
Jefferson City, Missouri

ATTENTION: Hon. Charles L. Henson
Chief Counsel

Dear Sir:

We have received your letter of July 12, 1940, which reads as follows:

"Upon the insolvency of the Royal Union Life Insurance Company and the Northern States Life Insurance Company liquidation was undertaken in the states of Iowa and Indiana respectively. The said companies respectively domiciled in those States.

The Lincoln National Life Insurance Company made contracts respecting each of these companies, a copy of which contracts is attached.

The Lincoln National Life Insurance Company is a foreign life insurance company domiciled in Indiana, and is licensed to do business in Missouri, and has been continuously licensed here for many years, and prior to and at the time these contracts were made.

The Lincoln National Life Insurance has raised the question as to whether or not the 2% premium tax on foreign insurance companies should be levied on premiums received from policyholders

> of the two defunct companies since the making of the contracts. Their position is stated in a brief which they are submitting, and which I attach hereto. The amount of the tax is not very large. But in view of the fact that half of such taxes go to the State Revenue Fund and the other half to the State School Fund, we regard the question here as one which should be passed upon by the Attorney General, and at the request of the Superintendent of Insurance, I am submitting it."

Section 5797, as amended, Laws of Missouri 1939, page 463, is the 2% gross premium statute to which you refer. The applicable part of this section reads as follows:

> "Every insurance company or association not organized under the laws of this state, shall, as hereinafter provided, annually pay tax upon the direct premiums received, whether in cash or in notes, in this state or on account of business done in this state, for insurance of life, property or interest in this state at the rate of two per cent per annum in lieu of all other taxes, * * * * *."

The Supreme Court of Missouri has several times determined that this statute, providing for a 2% gross premium tax, is an excise or privilege tax and is in no sense a tax on property; that it is a tax assessed for the privilege of doing business only. In the case of Bankers Life Company vs. Chorn 186 S. W. 681, the Supreme Court of Missouri en banc said the following in connection with this statute, l.c. 683:

> "It follows that the correctness of the conclusion reached in Northwestern, etc., v. Waddill, supra, depends upon the real character and purpose of the section of the statute (R. S. 1909, Sec. 7099), imposing a duty of 2 per cent. per annum upon the 'premiums' received by foreign insurance companies or associations on account of business done in this state, whether it was a property or a privilege tax. After mature consideration we are of opinion that this exaction was not intended to be a tax in the sense of an exercise by the Legislature of its power to tax property generally, but that it was in its essence an excise demanded for the privilege of plying the calling of insurance in this state, and was therefore not subject to the constitutional requirement of uniformity and equality, except as to the class affected, and applies directly to any class falling within its terms. 1 Cooley on Tax. (3d Ed.) pp. 6, 31, 72; Id. vol. 2, p. 1100; Black's Law Dict. title, Excise."

In the case of Massachusetts Bonding and Insurance Company vs. Chorn 274 Mo. 15, 201 S. W. 1122, the court in dealing with the 2% tax statute then in force, and which was in the same language as the present statute we have quoted above said:

> "The payment of the tax entitled it, under the laws of the state, to transact this business in its capacity as a corporation."

After quoting the tax statute in full, the court

in the above Massachusetts Bonding case said further:

> "It will be observed that the nature of the tax is a tax on 'business done' and not upon 'insurance furnished'".

The Supreme Court of the United States has also held that a state has no authority to impose a premium or excise tax on an insurance company when it has withdrawn from the state in question and is no longer licensed and is no longer issuing any policies of insurance in the particular state. This is true even though the company continues in force previously issued contracts of insurance from a place of business without the state. In the case of Provident Savings Life Assurance Society vs. Kentucky 239 U. S. 103, the court, speaking through Justice Hughes, said:

> "And we cannot doubt that the question whether the State is taxing a foreign corporation for a privilege not granted, that is, whether the acts done by the corporation at the time to which the tax relates are of such a nature as to subject it to the local authority upon the ground that it is doing acts which can only be done with the permission of that authority, must be regarded as a Federal question. Taxation without jurisdiction has been held to be a violation of the Fourteenth Amendment (Louisville & Jefferson Ferry Co. v. Kentucky, 188 U. S. 385, 398; Del., Lack. & West. R. R. v. Pennsylvania, 198 U. S. 341, 358; Union Transit Co. v. Kentucky, 199 U. S. 194, 209); and the principle involved applies to the assertion of authority on the part of the State to exact a license tax for the privilege of doing acts which lie beyond the sphere of local control. It follows that the quality of the acts with

respect to which the State exercises the taxing power must be considered when the constitutional protection against the transgression of jurisdictional limits is invoked.

It is not controverted that the Company, at the time in question, was not soliciting insurance or collecting moneys in that State. Further, it had no offices or agents in Kentucky. Upon the averments which stand admitted in the record it must be assumed that it was not performing any acts within the jurisdiction of Kentucky. It had sought to withdraw itself completely from the State. The conclusion that it continued to do business within the State, notwithstanding this withdrawal, appears to be based solely upon the fact that it continued to be bound to policy holders resident in Kentucky under policies previously issued in that State and that it received the renewal premiums upon these policies. As the policies remained in force, it is said that the Company continued to furnish protection to citizens of Kentucky. The renewal premiums, as already stated, were paid in New York. There is, however, a manifest difficulty in holding that the mere continuance of the obligation of the policies constituted the transaction of a local business for which a privilege tax could be exacted. As a privilege tax, the tax rests upon the assumption that what is done depends upon the State's consent. But the continuance of the contracts of insurance already written by the Company was not dependent on the consent of the State. It is true that acts might be done within the State in connection with such policies, as for example in maintaining an office or agents

> although new insurance was not written or solicited, which could be considered to amount to the continuance of a local business. In such case it would be the actual transaction of business that would furnish the ground of the license exaction, and not the mere existence of the obligation under policies previously written. These policies are contracts already made; the State cannot destroy them or make their mere continuance, independent of acts within its limits, a privilege to be granted or withheld. Neither the continuance of the obligation in itself, nor acts done elsewhere on account of it, can be regarded as being within the State's control."

It would follow, therefore, that since the Northern States Life Insurance Company and the Royal Union Life Insurance Company are in receivership and are no longer engaged in doing business in the State of Missouri as such corporations, that the excise or privilege tax cannot be assessed. This is true as against these two defunct companies which have not been doing business as such in the State of Missouri for a number of years. The Lincoln National Life Insurance Company has been doing business in Missouri during all the time in question, and the exact nature of the two reinsurance contracts must now be examined to determine whether the business of the two defunct companies has been so absorbed and assumed by the Lincoln as to render the Lincoln liable for the 2% premium tax as of this time.

From the contract it appears that the Lincoln is acting as trustee of the business and assets of the two companies and that neither the business nor assets constitute property of the Lincoln. In fact, the payment of death benefits and the other obligations of the Royal Union and the Northern States do not

become obligations of the Lincoln until December 31, 1948, unless it becomes possible to fully retire the policy liens prior to that time. In this connection, Section 32 of the Royal Union contract reads in part as follows (the word "company" refers to the Lincoln National):

> "All assets conveyed (excluding those covered by Paragraph 39 hereof) and sums paid by the Receiver to the Company, together with all net gains and profits from the business reinsured, and from the assets administered by the Trustees as hereinafter provided, shall constitute the Royal Union Fund. The Company shall separately account for the Royal Union Fund, and so set the same apart that it will not be subject to claims or demands by other policyholders or creditors of the Company. Assets of the Royal Union may be acquired by the Company at agreed upon values in the manner as hereinafter provided but the same shall still constitute a part of the Royal Union Fund. * * * * As provided elsewhere in this Contract, the policies assumed shall become (except for any final lien which may be determined) the obligation of the Company on December 31, 1948 or at such earlier date as the lien (including all additions thereto on account of unpaid interest and accrued interest) upon all policies shall have been completely removed and all matured endowments paid in full as provided in Paragraph 26. The contingency reserve shall not be regarded as a liability in determining when the lien upon all such policies shall have been completely removed. The Royal Union Fund shall

continue to exist until December 31, 1948, unless the lien is sooner discharged. Upon said termination, or discharge of the lien, the assets constituting the Fund with all incidents thereof shall be considered the same as other assets of the Company. The Company shall have the right to recover with interest at five per cent (5%) per annum out of the Royal Union Fund all amounts that it may advance to cover the payment of claims or other valid disbursements except such claims as the Company may be required to pay out of its own funds as provided herein."

Section 33 reads in part as follows:

"As stated in Paragraph 17, the Company shall render an accounting of all transactions pertaining to the business of the Royal Union as soon as practicable after the end of each calendar year as long as a lien exists against Royal Union policies but in no event after December 31, 1948. Such accounting shall be in the form of a Convention Annual statement, which shall be furnished to the Court and the Commissioners of Indiana and Iowa, and when approved by the Commissioner of Iowa shall be conclusive and binding on policyholders.

Until December 31, 1948, all net profits as defined herein, unless the lien is sooner discharged, shall inure to the use and benefit of the policyholders of the Royal Union

entitled thereto under this Contract. If said lien (including all additions thereto on account of unpaid interest and accrued interest) is discharged before December 31, 1948, the Company, at the time of such discharge, will assume the policies hereby reinsured according to their respective terms except as to those benefits which are definitely limited or modified by the terms of this agreement. All profits earned after discharge of the lien and in any event after December 31, 1948 shall become the sole property of the Company."

Section 40 provides in part as follows:

"If the insured named in any policy reinsured hereunder shall make application to the Company to have his policy exchanged for a new policy issued by the Company on its own form, such new policy to be free from the lien provided by this Contract, the Company may issue such new policy as applied for and credit thereto any amount to which the insured would then become entitled under the terms of this Contract. Any and all rewritten policies shall be considered Royal Union policies for the purpose of this Contract."

Section 42 provides as follows:

"For administration expenses incurred in handling the policies of the Royal Union, the Company shall receive $2.00 per thousand per annum for all policies

> except extended insurance policies and group insurance policies. The charge for administration expenses in connection with extended insurance shall be $1.25 per thousand per annum and for group insurance 75 cents per thousand per annum."

Section 49 provides in part:

> "It is specifically understood that the Company does not assume any liability of the Royal Union except as set out herein."

Section 53 provides in part that:

> "The Court shall retain exclusive jurisdiction over all matters pertaining hereto for the purpose of entering such other necessary and further orders, from time to time, as occasion may require."

It appears, therefore, that all of the assets conveyed to the Lincoln are to be maintained and administered separate and apart from the assets of the Lincoln and are to be administered as the Royal Union Fund; that the policy and other obligations are not to become direct obligations of the Lincoln until December 31, 1948, unless the lien is sooner terminated; that upon the discharge of the lien, or upon December 31, 1948, the assets constituting the "Royal Union Fund" are to become the property of the Lincoln; that in the meantime, all policy claims and other expenses in connection with the Royal Union policies are to be paid out of the fund itself and not out of the assets of the Lincoln, and if the Lincoln should advance any such items, it can recover the amounts so paid out of the fund with 5% interest.

It is further provided that the Lincoln shall make

an annual and separate accounting to the court and the Commissioners of Insurance of Indiana and Iowa. Even if a Royal Union policy is rewritten in the Lincoln, the new policy is to be considered a Royal Union policy. Also, the Lincoln receives a certain sum per $1,000.00 insurance as compensation for administering the business and assets.

It appears, therefore, that the business and assets of the Royal Union cannot now be considered as business and assets of the Lincoln National Life Insurance Company. While the provisions we have quoted herein are taken from the contract involving the Royal Union, it will be sufficient here to observe that the effect of the contract with the Northern States is substantially the same.

It appears, therefore, that the business and funds now being administered by the Lincoln are not now its own business, and it should not be required to pay the 2% tax out of the trust funds. The premiums are not received by the company nor do the same go into the assets of the Lincoln. The premiums go into the funds. The conduct of the Lincoln's business is separate and apart from its administration of these funds. In fact, if the management of the affairs of the Royal Union and Northern States had been carried on in the same manner by the original receivers, and if these reinsurance contracts had not been entered into, there would be no question but that the tax could not be imposed. The same would be true if the court had appointed individuals to manage these trust estates or if the reinsurance contracts in question had been entered into with an insurance company not licensed to do business in the State of Missouri. In other words, if the Lincoln National had never been licensed to do business in the State of Missouri, there would be no question that the tax could not be imposed.

Again, as to the nature of the contract in question, the Supreme Court of Indiana, in the case of Morthland v. Lincoln National Life Insurance Company, 25 N. E. (2d) 325, held that under the contract in question between the Lincoln National and the Northern States, the Lincoln held

"the bare legal title to those assets for the purpose of administering them in connection with the continuance of the insurance policies of the Northern States Life In-

surance Company which were outstanding, and that the equitable title continued in the trustee, the officer of the court."

For your further information, we are attaching copy of an opinion dated June 14, 1940, written by the Attorney General of the State of Minnesota and addressed to the Honorable Frank Yetka, Commissioner of Insurance of the State of Minnesota, in which the same result is reached on the same companies involved.

CONCLUSION

We conclude, therefore, that the premium tax statute provides a privilege or excise tax predicated on the state's grant of authority to transact the insurance business, and if no authority is granted, the tax cannot be collected.

Since the Royal Union Life Insurance Company and the Northern State's Life Insurance Company have been in receivership for a number of years, and are not now licensed to do business in Missouri, and since the business of these two companies has not at this time become a direct obligation of the Lincoln National Life Insurance Company, and since the Lincoln National is acting now in the nature of a trustee in administering the business and assets of said two companies, it follows that the 2% tax cannot be collected from either of the two companies or the Lincoln National at this time.

Following the year 1948, or at an earlier time, if the policy liens can sooner be lifted and the assets and business become a direct part of the assets and business of the Lincoln National, a different matter will be presented. However, there can be no purpose at this time in going into that future question.

Respectfully submitted,

APPROVED:

J. F. ALLEBACH
Assistant Attorney General

COVELL R. HEWITT
(Acting) Attorney General

JFA:RT