

Opinion No. 13-1045

May 15, 1913

BY: FRANK W. CLANCY, Attorney General

TO: Honorable Jacobo Chaves, Superintendent of Insurance, Santa Fe, New Mexico.

INSURANCE.

Opinion as to meaning of the words "returned premium."

OPINION

{*211} I have before me, by reference from your office, several letters addressed to you on the subject of the construction of Section 11 of Chapter 5 of the Laws of 1905 as amended by Section 2 of Chapter 48 of the Laws of 1909, which requires all insurance companies engaged in the transaction of the business of insurance in New Mexico, annually, on or before the first day of February in each year, to pay to the Superintendent of Insurance two per centum of the gross amount of premiums received, less returned premiums within New Mexico, during the year ending the previous 31st day of December. The only substantial change by the amendment of 1909 is the provision for the deduction of returned premiums from the gross amount upon which the two per cent tax is to be paid. The letters referred to are as follows:

{*212} A letter from James H. McIntosh, General Counsel of the New York Life Insurance Company dated April 30th.

A letter from E. D. Jones, Assistant Secretary of the North-western Mutual Life Insurance Company, dated May 5th.

A letter from J. L. English, Vice-President of the Aetna Life Insurance Company, dated April 29th.

I have also a letter from Commissioner Owen of the State Corporation Commission dated May 7th, relating to the statements and views set out in the letter of Mr. McIntosh, and I have found the suggestions made by Mr. Owen of value in reaching a conclusion as to the meaning of the statute.

The subject of controversy appears to be as to whether "returned premiums" mentioned in the statute can be construed to cover what are called "dividends" by the mutual insurance companies, of which policy holders are permitted to make use in any one of several different ways at their option, the most common use perhaps being in abatement of the full amount of the annual premium stipulated in the policy of insurance. Mr. McIntosh takes the position that these "dividends" are nothing but "returned premiums" and should, therefore, be deducted from the gross amount of

premiums received. Mr. Jones takes the position that the phrase "returned premiums" does not apply to life insurance companies but refers only to fire insurance companies, but still, if these dividends are not actually received by the mutual life insurance companies, they cannot be allowed to figure as a part of the basis of the two per cent tax, as that tax is to be only upon premiums received. The practical conclusion reached by these two gentlemen is the same as to the amount of tax to be had in those cases where the dividends are by the policy holders applied to the payment in part of their annual premiums.

The argument of Mr. McIntosh is, in substance, that the full amount of premium fixed in the policy is made larger than may perhaps be necessary to conduct the business of the company, and that there is an agreement with the policy holder that if, after the risk is assumed, actual experience shows that the company does not need as much money as the full premium stipulated for carrying the risk, then the company will return to the policy holder such excess payments and that these so-called "dividends" are mere excess premium payments returned to the policy holders and should therefore be deducted in making tax returns for his company. He cites the statutes of several states and the opinion of the Supreme Court of Kentucky in the case of Mutual Benefit Life vs. Kentucky, 107 S. W. 802, to support this view. The difficulty which I find is substantially set forth by Mr. Owen in his letter, and that is that there is no such agreement with the policy holders. I have before me the form of a New York Life policy which, among other things, declares that the policy and the application therefor constitute the entire contract between the parties, and I am unable to discover anywhere in the contract any such agreement with the policy holder as Mr. McIntosh in his letter declares that the company makes. On the contrary, it appears that the policy holders are to be allowed to participate in the surplus accumulated by the company in its management, no matter from what source that surplus is derived. I believe it is generally understood that mutual companies divide the profits of their management {^{*213}} among their policy holders, who are led to believe that by the clearly efficient business methods employed by the companies there is a certainty of profit, the certainty and safety off-setting the low rates of interest which may be hoped for, and aside from this there must be large accumulations of surplus from lapsed and forfeited policies, all of which is in the nature of gain or profit in the business of the company. In the form of the policy there is a heading "Participation in Surplus" under which appears the following matter:

"The proportion of divisible surplus accruing upon this policy shall be ascertained and distributed annually and will not be conditioned upon the payment of the next premium. At the option of the insured such dividend shall each year, on the anniversary of the policy, be either

- (a) Paid in Cash; or,
- (b) Applied toward the payment of any premium or premiums; or,
- (c) Applied to the purchase of a participating Paid-up Addition to the sum insured; or,

(d) Left to accumulate to the credit of the Policy at such rate of interest as the Company may declare on such funds, and payable on the maturity of the Policy or withdrawable in cash on any anniversary date of the insurance. The rate of interest shall not be less than three per centum compounded and credited annually.

If the Insured fails to notify the Company in writing, within three months after the Company shall have mailed to him a written notice of the amount of said dividend and the options available as aforesaid, which option he selects, the Company shall then apply said dividend to the purchase of a paid-up addition to the sum insured. Such paid-up addition may be surrendered for cash at any time, and the Cash Value thereof shall not be less than the original cash dividend."

Certainly there is nothing here to indicate an agreement with the policy holder to return to him any excess of the stipulated premium above what is necessary to enable the company to carry the policy. That which is to be given to the policy holder is the "proportion of divisible surplus accruing upon this policy," without any suggestion that such surplus is made up of excessive charges in the premium originally stipulated.

There are other provisions in the policy by which policy holders are given the right to borrow money on their policies, paying interest at the rate of six per centum per annum. Undoubtedly very large amounts of money are loaned in this way and the interest thus collected must be in the nature of profits on the business which go to increase the divisible surplus. The same way be said of every other form of investment of the company's money from which it receives any return. These various things are in the nature of profits and are properly payable to the policy holders in the form of dividends and it is no misnomer, as has been suggested, to call these payments "dividends." From the quotation above made, it is plain that the policy holder may use his dividend in any one of four different ways, and there is no hint that they are merely returns of premiums paid, or agreed to be paid.

{*214} In the various opinions of state officers and of the Kentucky Court, referred to by Mr. McIntosh, I do not discover that any consideration whatever has been given to the essential and material matters which I have briefly indicated, and I find myself unable to agree with Mr. McIntosh.

Mr. Owen, in his letter hereinbefore referred to, points out with great clearness that if the dividends are taken by the policy holder and applied upon his premium the policy, at maturity, will be worth only its face value, but if allowed by the policy holder to accumulate the value of the policy at maturity is thereby increased. Therefore, in making the "return dividends" or "returned premiums," or whatever they may be called, the company obtains a credit which lessens its obligation to the policy holder by a reduction of its value at maturity, and this strengthens the view that these dividends constitute profits of the insurance company and inure to its benefit and should therefore be considered as part of the payments upon which the tax is calculated.

Mr. Jones of the Northwestern Company, in his letter, I believe correctly, takes the position that "returned premiums" cannot apply to life insurance companies and that there is no such thing as a "returned premium" in the business of life companies. With great ingenuity, however, he argues that when the policy holder applies his dividend in part payment of his premium, the company actually receives only the remainder of the premium after the deduction is made and that, therefore, it should be taxed only upon the money which it actually receives. This seems very plausible, but this is no more sound than the contention of Mr. McIntosh. The company, in effect, agrees with the policy holder that it will insure his life for the payment of a specified annual premium and also that it will give to him, annually, his share of the surplus or profits accumulated by the company in the management of its business, such share being in proportion to the amount and age of the policy. Now, whether this division is made by actual payment to the policy holder in cash, or by applying his share to the payment of his premium, can make no difference. If the policy holder takes a dividend in cash, then he pays the full amount of the premium stipulated in the policy, but if, without actually receiving it in cash, he applies it on that payment, the premium is fully paid just as much as though he had given his check for the full amount of the premium. If he allows it to accumulate, as provided in the policies, he gets his share of the profits but still pays the full amount of the premium. It seems to be mere juggling with words to attempt to say that, in any event, he does not pay the full amount of the stipulated premium.

The language used in one place in Mr. Jones' letter is quite significant:

"The word "dividend" used in connection with a mutual life insurance company does not in any sense indicate a profit, but has reference strictly to savings from the Company's mortality experience, expense of management and interest earnings."

It is difficult to see how anyone can contend that savings from the mortality experience, savings from expense of management and from interest earnings, are no indication of a profit on the business {²¹⁵} of the company. If a person, in any kind of business, can reduce his expenses -1,000.00 a year, while continuing to do the same amount of business, he clearly adds that \$ 1,000.00 to his annual profit; and if he loans money and collects interest upon such loans, they are part of the earnings of his business and should, in part at least, figure in the profits. The policy holder is getting merely his share of the profits in the form of these dividends.

The letter from the Vice-President of the Aetna Life Insurance Company takes up an entirely different point. He insists that the tax should be paid only on premiums received by his company within the state. In other words, if the premiums are received by his company at its office in Hartford, Connecticut, although the premiums come from policy holders in New Mexico, no tax can be collected. The language of our statute upon which this argument is based is that which requires each company, annually, to "pay to the superintendent of insurance two per centum of the gross amount of premiums received, less returned premiums within this territory, during the year ending the previous 31st day of December." If the position taken by Mr. English can be sustained, it would be possible for every foreign insurance company doing business in New Mexico, so to

arrange its business that it would pay no tax whatever upon premiums received. The legislative intent is plain that a tax shall be paid and no construction of the statute can be permissible by means of which that intent could be wholly defeated. The construction contended for on behalf of this company is of a very narrow and petty character, and one of the same kind could be made in answer thereto by asserting that the words "within this territory," have no reference back to the verb "received," but can refer only to the returned premiums. This is quite as good an argument as the one suggested by Mr. English in his letter. The reasonable construction, however, is that premiums received in New Mexico mean the premiums which are paid upon policies of insurance, whether on lives or property, which are carried within the state.

I return to you herewith the several letters from Messrs. McIntosh, Jones and English.