1951

Sept 26
Nov. 7

BETWEEN:

MINISTER OF NATIONAL REVENUE, APPELLANT;

AND

STANLEY MUTUAL FIRE INSURANCE COMPANY ..... RESPONDENT.

Revenue—Income—Income Tax—Income War Tax Act 1927, c. 97, s. 4 (g) —Mutual insurance company—Appellant not a mutual company in true sense—Appeal allowed.

Held: That respondent company is not entitled to exemption from income tax as provided by s. 4 (*g*) of the Income War Tax Act since it is not a mutual company in the true sense.

2. That since the reserve or surplus belongs to the company only it must be regarded as a profit or gain to it and not to its members.

3. That the respondent is not merely an agency or trustee for its members but is a separate corporation distinct from them.

APPEAL from the decision of the Income Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Hyndman, Deputy Judge of the Court, at Saskatoon.

D. E. Mundell, K.C. and *F. J. Cross* for appellant.

W. B. Francis, K.C. and *D. E. Gauley* for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

HYNDMAN D.J. now (November 7, 1951) delivered the following judgment:

This is an appeal by the Crown from a judgment of the Tax Appeal Board (1). The case was heard before the chairman, the Honourable Mr. Justice Graham, and Mr. Monet and Mr. Fisher. The chairman and Mr. Monet held that the company being a mutual insurance company was not liable for the tax assessed against it, Mr. Fisher dissenting.

The facts are fully set forth in the very able reasons of the chairman, with whom Mr. Monet concurred, and for the record I deem it convenient to repeat the salient facts as found in the said judgment as follows:

The appellant is a provincial mutual company incorporated under the laws of the Province of New Brunswick and carries on the business of a fire insurancec company in the rural areas of that province. It

(1) (1950-51) 3 Tax A.B.C. 96.

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insures against loss by fire, lightning or explosion upon farm or other non-hazardous property under the premium note plan subject to the provisions of and regulations under the statutes of the Province of New Brunswick . . . the business is not wholly confined to the insurance of churches, schools or other religious, educational or charitable institutions and, therefore, does not come within the saving provision of section 4, paragraph (g), of the Income War Tax Act.

Under the laws of the Province of New Brunswick such a mutual company can have no shareholders but each person, partnership or corporation insured under a policy issued by such company shall be a member thereof.

The company operates under what is described as the premium note plan. Under such a plan a person taking out a policy of insurance gives a promissory note for the premium based on the tariff of rates fixed by the Board of Directors. At the time of giving the premium note, he makes a cash payment of a prescribed percentage of the total amount.

The member's liability is limited to the extent of the amount of the premium note signed by him. The statute provides that if the down payments received are more than sufficient to pay all losses and expenses during the continuance of the policy, then any surplus shall become part of the reserve fund. If, however, the company requires more money to meet losses or expenses it may make further assessments on each member, limited by the balance owing under his premium note. Again any surplus resulting therefrom shall become part of the reserve fund.

In addition to the first payment it is provided that the insurer shall make an annual assessment on the premium notes of not more than twenty-five per cent nor less than five per cent until the reserve fund reaches the sum of $500 for each $100,000 in force on the first $1,000,000 of risk carried and $3,000 on each additional $1,000,000 in force thereafter.

Section 249(2) of the Insurance Act, Chapter 44, R.S.N.B. 1937, provides that this reserve fund may be used to pay off such liabilities of the insurer as are not provided for out of ordinary receipts.

The Act further provides that the reserve fund shall be the property of "the insurer as a whole" and no member shall have a right to claim any share or interest therein in respect of any payment contributed by him towards it; nor shall such funds be applied or dealt with by the insurer or the Board other than in paying its creditors, except on the order of the Governor in Council.

Section 230(2) of the Act provides that "every application and policy shall bear the words 'mutual company—subject to pro rata distribution of assets and losses.'" These words must be printed or stamped in large type and in red ink at the head of the policy.

Neither the charter of the company nor the statutes pertaining to such a company make any specific provision for the distribution of any surplus in the event that the company is wound up. However, it will be noted that the Act declares the reserve fund to be the property of the "insurer as a whole" . . .

The New Brunswick Winding-up Act, Chapter 97, R.S.N.B. 1927, is made applicable under its provisions "to all companies heretofore or hereafter incorporated by the legislature or under the authority of any statute of this province". Section 19 reads as follows:

"If there is any surplus of the funds realized from the assets of the company, after the payment of all the creditors thereof in full, the same shall first be devoted to the adjustment of the rights of the contributories among themselves, and afterwards shall be distributed pro rata among the contributories."

"Contributory" as defined by the said Act means every person liable to contribute to the assets of a company in the event of the same being wound up and includes a creditor or stockholder of a company. (The Chairman observed: "There have been judicial decisions that would expand on some occasions the meaning of the word "contributory" to include a member. However, in the case under review a member of the appellant company is one who is insured against certain risks under a policy issued by the company. It is apparent, therefore, that in either case the word "contributory" would be limited to the members and policy holders at the time of the winding up of the company.")

The chairman further goes on to say:

The issue then in this appeal can be simply stated: Does the surplus over payment of losses and expenses of administration constitute profits subject to income tax under the provisions of the Income War Tax Act?

Such surplus in the case of the appellant can arise only from

(*a*) payment in of membership fees of $1 per member,

(*b*) initial payment of a percentage of premium notes,

(*c*) further assessments of an added percentage of amount still owing under premium notes, if deemed necessary, and

(*d*) special assessments of a percentage of amount of premium notes in order to build up reserve to at least a minimum amount required under the provisions of the statute.

There is one other source of revenue, and that is interest earned on the investment of funds lying in the reserve. It is admitted that such interest is income within the meaning of the Income War Tax Act and as such is taxable. This appeal is, therefore, concerned only with the revenue derived from membership fees and assessments.

The majority judgment of the Board held that the respondent company is a genuine mutual company and its operations bring it within the principles governing mutual companies with regard to taxation as laid down by the authorities hereinafter referred to, and that consequently it could not be held that there is any "profit" or "gain" or "income" within the ambit of the Income Tax Acts. Mr. Fisher on the other hand was of the opinion that the company was not a truly genuine mutual company and therefore any surplus after payment of losses and expenses was properly taxable.

I have studied most of the important decisions bearing on the subject of mutual concerns and find that, running through each one of them, is the fact or assumption that the contributories or members are also the owners of the

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surplus or reserve funds set up obviously for protection against future possible claims or liabilities; that there is complete identity between the contributory members and the participators, in other words genuine mutuality.

Up to the end of 1946 section 4(*g*) of the Income War Tax Act read as follows:

> 4. The following income shall not be liable to taxation hereunder.
>
> (*g*) the income of mutual corporations not having a capital represented by shares, no part of the income of which inures to the profit of any member thereof and of life insurance companies, except such amount as is credited to shareholders' account.

But in 1946 an amendment was enacted applicable to the 1947 income tax year and section 4(*g*) now reads as follows:

> 4. The following income shall not be liable to taxation hereunder.
>
> (*g*) the income of mutual corporations not having a capital represented by shares, no part of the income of which inures to the profit of any member thereof except mutual insurance companies that do not derive their premiums wholly from the insurance of churches, schools or other religious, educational or charitable institutions.

I am in agreement with the Chairman of the Board that in the case of a purely mutual concern the wording of the said amendment fails to accomplish its purpose for the reason that there can be no "profit" or "income" as defined by the Income Tax Act except, however, income such as interest on investments and returns from business carried on with persons outside the membership of the company.

The leading case relied on by the respondent herein is *New York Life Insurance Co.* v. *Styles* (1). Lord Herschell at p. 408 said:

> The chief part of the surplus shewn by the accounts to which I have referred is paid, or, as the company alleges, is returned to the policy-holders (that is, to members of the company) as bonuses. The remainder of the surplus is carried forward as funds in hand to the credit of the general body of the members of the company. These bonuses are not paid in cash, but the amount of the same is deducted from the next premium due or is added to the policy. The only question raised by the case is whether the surplus, so far as the same is derived from the premium income received from members of the company in respect of their policies, is a profit or a gain of the company liable to be assessed to income tax under Schedule D of the 16 & 17 Vict. c. 34.

(1) (1889) 14 A.C. 381.

Again, at p. 409 Lord Herschell goes on to say:

In the case before us certain persons have associated themselves together for the purpose of mutual assurance; that is to say, they contribute annually to a common fund, out of which payments are to be made in the event of death to the representatives of the persons thus associated together. These persons are alone the owners of the common fund, and they, and they alone, are entitled to the management of it. It is only in respect of his membership that any person is entitled to be assured a payment upon death.

Lord MacNaghten at p. 412 said:

I do not think that that decision compels your Lordships to hold in a case like the present, where the business is a mutual undertaking pure and simple, that persons who contribute in the first instance more that is wanted, and then get back the difference, are earning gains or profits, and so liable to income tax.

In *Jones* v. *South-West Lancashire Coal Owners' Association* (1), Viscount Cave, L.C., quoting from Lord Watson in the *Styles* case, said:

When a number of individuals agree to contribute funds for a common purpose, such as the payment of annuities, or of capital sums, to some or all of them, on the occurrence of events certain or uncertain, and stipulate that their contributions, so far as not required for that purpose, shall be repaid to them, I cannot conceive why they should be regarded as traders, or why contributions returned to them should be regarded as profits. That consideration appears to me to dispose of the present case. In my opinion, a member of the appellant company, when he pays a premium, makes a rateable contribution to a common fund, in which he and his co-partners are jointly interested, and which is divisible among them, at the times and under the conditions specified in their policies. He pays according to an estimate of the amount which will be required for the common benefit; if his contribution proves to be insufficient he must make good the deficiency; if it exceeds what is ultimately found to be requisite, the excess is returned to him.

Viscount Dunedin at p. 833 said:

The whole case for the Crown rests on the idea that because in a single year the premiums received exceed the sums paid in respect of the losses in that year the balance represents a profit. It represents no such thing. It is simply a sum of money which is carried forward in order that it may be available to meet excessive losses in a future year, or, if it is found in the end to be redundant, be returned to the shareholders either in the form of reduced premiums or of cash. The basis of the Crown's case seems to me to fail, apart from the fact that I agree that the present case is absolutely ruled by the case of *New York Life Insurance Co.* v. *Styles*.

In *Municipal Mutual Insurance Ltd.* v. *Hills* (2), Lord Warrington at p. 65 said:

Mutual insurance business is now perfectly well known. It consists essentially in the association of a number of persons who insure each

(1) (1927) A.C. 827 at 830. (2) (1932) 147 L.T.R 62.

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other against certain risks by contributing by way of premiums to a common fund to be used, together with further contributions if necessary, for the purpose of indemnifying any member or members who may have suffered injury in consequence of a risk insured against, any surplus being either carried forward or used to reduce future premiums *as the members may determine.*

Lord Macmillan at p. 67 said:

> The principle on which the surpluses arising in the conduct of a mutual insurance scheme are not taxable as profits is now well understood.

At p. 68 Lord Macmillan further stated:

> The cardinal requirement is that all the contributors to the common fund must be entitled to participate in the surplus and that all the participators in the surplus must be contributors to the common fund; in other words there must be complete identity between the contributors, and the participators. If this requirement is satisfied the particular form which the association takes is immaterial.

The decision in *M.N.R.* v. *Saskatchewan Cooperative Wheat Producers, Ltd.* (1), is clearly distinguishable from the present case inasmuch as it was there held that the corporation never became the owners of the reserve, but acted merely as trustees or agents of the farmers who contributed the grain, and for which they were given certificates of ownership. Furthermore, the company's books showed it was a debtor to the individual farmers who contributed to the reserve.

The real issue in this case, therefore, is whether or not the Stanley Company is, in fact and in essence, a genuine mutual company as defined by the leading authorities. It is true that the New Brunswick Act creating the company insists on it being called a "mutual company." But in my opinion so calling it does not of necessity make it such, at least in relation to legislation of the Dominion Government such as the Income Tax Acts. As I stated above, the essential features of mutual concerns is that the contributors to the funds must also be participators in the surplus. The very Act under which the company operates expressly and in clear language states that "the reserve funds shall be the property of the insurer as a whole and no member shall have a right to claim any share or interest therein in respect of any payment contributed by him towards it." It may be said that in the case of a winding up the then members would be entitled to their appropriate

(1) (1930) S.C.R. 402.

shares of any assets remaining after payment of all claims. That position, however, applies to any ordinary company or association.

It is also my view that there is a clear distinction between the "company" and the shareholders. It is not a case of the members together insuring the individual members against fire. The insurer is the "company" and not the body of the members. There is no provision for a reduction of premiums as the reserve increases as is the case in purely mutual concerns. The premiums are fixed or based upon the estimated or predicted losses and expenses each year and not in reference to the size of the reserve. As I see it, the very same conditions are taken into consideration in fixing premium rates as in the case of an ordinary fire insurance company. The reserve is built up, and properly so, for future use in the event of excessive losses and is expressly to be utilized for the payment of creditors. The members are liable only to the extent of the full amount of the premium notes and no further. It also provides that payments may be made on the order of the Governor in Council, but I think that is simply for extra protection against possible enterprises or investments which might be considered questionable or improvident. There is nothing in the legislation which provides or implies any payment to members or reduction of their premiums. If I am right in this view then it seems to me there is no real distinction between this so-called mutual company and any ordinary fire insurance company. It is merely a device or method to obtain cheaper insurance than can be got from the line companies. Beyond that I can see no substantial difference between them.

I think a fair question to ask is to whom does the reserve fund belong? Someone must own it. If by the Act under which the corporation was created, no member shall have a right to claim any share or interest therein in respect of any payment contributed by him towards it, and it can be used only to pay creditors, then it must follow that it belongs to the company only, and any mutuality disappears. Such surplus then, in my opinion, must be regarded as a profit or a gain to it and not to the members. It is not, therefore, a mutual company in the true sense and does not fall within any of the exemptions

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provided for in the Income War Tax Act, and consequently taxable. In my view, the company is not merely an agency or trustee for the members, but a separate corporation distinct therefrom.

I agree substantially with the reasoning of Mr. Fisher in his dissenting judgment, with the greatest deference to the very able reasoning of the learned Chairman of the Board.

For the above reasons, therefore, I would allow the appeal and confirm the assessments of the Minister. The appellant is entitled to costs if it insists upon same.

Judgment accordingly.