CASES

DETERMINED BY THE

EXCHEQUER COURT OF CANADA

AT FIRST INSTANCE

AND

IN THE EXERCISE OF ITS APPELLATE JURISDICTION

BETWEEN:

HIS MAJESTY THE KING, ON THE INFORMATION OF THE ATTORNEY GENERAL OF CANADA	PLAINTIFF,	1947 Nov. 13 Nov. 29
AND			
CENTRAL MANUFACTURERS' MUTUAL INSURANCE COMPANY	DEFENDANT.		

Revenue—Special War Revenue Act R.S.C. 1927, c. 179, s. 13(f), 14(2)—"Rebates"—"Dividends"—"Cancellation of policies"—Insurance company operating as mutual company distributing money to policyholders out of surplus and revenue derived from sources other than premiums is paying a dividend and not distributing a rebate.

The Special War Revenue Act, R.S.C. 1927, c. 179, s. 13(*f*), as in force in the year 1944, provided that "net premiums" in the case of a mutual insurance company means "the gross premiums received or receivable by the company or paid or payable by the insured, less the rebates and return premiums paid on the cancellation of policies". Defendant is a Fire and Casualty Insurance Company operating as a mutual company with no shareholders. Each policyholder, while his policy is in force, is a member. The premiums are fixed and are paid in cash It does not carry on the business of life insurance and does not carry on business on the premium deposit plan It filed its statement as required by the Special War Revenue Act, for 1944, and claimed a reduction of $19,502 82 for what it described as "less rebates to policyholders of unabsorbed premium refunds (dividends)". The Crown claims the tax on the said $19,502 82.

In 1944 the company had no operating surplus and the money paid to a policyholder was paid only after taking into consideration revenue from other sources, including income from surplus and reserves to which many of the policyholders who received the payments in 1944 contributed little, if anything. The money was not paid on the cancellation of policies.

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Held: That the money distributed by defendant to its policyholders in 1944 was not a rebate; it was a dividend and defendant was not entitled to deduct the distribution from its gross premiums.

2. That the only deductions which may be made by the defendant from its net premiums are those moneys returned to policyholders upon the cancellation of the policies, either by the insured or by the insurer, since the words "paid on the cancellation of policies" in s 13(*f*) of the Special War Revenue Act relate not only to "returned premiums", but also to "rebates", there being no material distinction between them.

Information exhibited by the Attorney General of Canada to recover from the defendant the balance of tax levied upon defendant by virtue of s. 14(2) of the Special War Revenue Act.

The case was tried before the Honourable Mr. Justice Cameron at Toronto.

J. W. Pickup, K.C. for plaintiff.

Hon. S. A. Hayden, K.C. for defendant.

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

CAMERON J. now (November 29, 1947) delivered the following judgment:

In these proceedings the plaintiff claims from the defendant the sum of $585.08, said to be the balance due in respect of the 3 per cent tax levied by section 14 (2) of the Special War Revenue Act, R.S.C. 1927, c. 179, and amendments thereto, for the year 1944. The defendant is a Fire and Casualty Insurance Company incorporated under the laws of the State of Ohio, carrying on business in the United States and Canada. It is a Mutual Company having no shareholders but each policyholder, while his policy is in force, is a member. It does not carry on the business of life insurance, nor does it carry on its business on the premium deposit plan. Its premiums are fixed and are paid in cash.

The defendant duly filed its statement for the year 1944 (ex. 1) and paid the tax on what it deemed was its actual net premiums. In the printed statement which it was required to file (ex. 1) it inserted a special clause—2a—

claiming a reduction of $19,502.82 for what is described as "less rebates to policyholders of unabsorbed premium refunds (dividends)". It is in respect of this sum that the dispute arises between the parties.

By section 4, chapter 32, of the Statutes of 1942, a former section 13 (*f*), defining "net premiums", was repealed and for it was substituted a new section 13(*f*) as follows:

"net premiums" means, in the case of a company transacting life insurance, the gross premiums received by the company other than the consideration received for annuities, less premiums returned and less the cash value of dividends paid or credited to policyholders; and, in the case of any other company, the gross premiums received or receivable by the company or paid or payable by the insured less the rebates and return premiums paid on the cancellation of policies: Provided that in the case of a mutual company which carries on business on the premium deposit plan and in the case of an exchange "net premiums" means the actual net cost of the insurance to the insured during the taxation period together with interest on the excess of the premium deposit over such net cost at the average rate earned by the company on its funds during the said period

This section was in effect for the year 1941 and remained unchanged until it was repealed as of December 31, 1946, and another section substituted. For the year 1944, therefore, "net premiums" was defined as above. That part of the section which in 1944 was applicable to the defendant company was, therefore:

Net premiums means the gross premiums received or receivable by the company or paid or payable by the insured, less the rebates and return premiums paid on the cancellation of policies.

It is common ground that the sum of $19,502.82 was not paid on the cancellation of policies. To succeed, therefore, the defendant must establish two things: (1) that the sums so paid were "rebates" and; (2) that the words "paid on the cancellation of policies" have no application to the word "rebates"; for, if they do, it follows that not having been "rebates paid on the cancellation of policies" the defendant is not entitled to deduct them.

The evidence of Mr. Millar, Chief Agent in Canada of the defendant company, indicates the nature of the payments to policyholders. His entire examination for discovery was read into the record by counsel for the plaintiff and, with certain exhibits filed by both parties, constitutes all the evidence. It is shown that payments are made only

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to policyholders whose policies expire in the quarter for which a specific "dividend" has been declared by resolution of the directors. Those who have ceased to be policyholders, and also holders whose insurance does not expire in that quarter, receive no benefits. The "dividend" is paid out of the reserves which the company has built up over the years.

In reply to a question as to how the amount to be paid to policyholders at any particular time is arrived at, Mr. Millar said:

> Well, of course the determination by the Board of Directors of the dividend is naturally, as in any business, based upon the financial condition as of a given time. The Board of Directors some years ago set up, very much as the Life Companies, a reserve for dividends as shown in our statement here, which is the latest statement, a voluntary reserve for dividends. That is the quarterly dividend which the Board of Directors sanction, so every quarter they determine through their Statistical Department the earned dividends for a given term, either one year or three years, whichever it happens to be. They determine the amount of dividends earned and set up this voluntary reserve for dividends.

Mr. Millar further stated that the Board determines the percentage or rate which applies for any class of insurance. They know from their experience in the business the loss ratios on a given type of business and naturally the loss ratio developed by this type of business has a bearing upon the amount of the dividend rate that they would declare on that type of business. No difference is made between policies written in Canada and those written in the United States.

The following is a resolution passed by the Board on August 18, 1944, and is typical of all such resolutions in respect of the year 1944.

> RESOLVED, that on all policies expiring during the months of March, April and May, 1944, and so long as the condition of the Company shall in the judgment of the Executive Committee warrant and until further action of the Board, there shall be returned to policyholders unabsorbed premiums or dividends at the percentage of the premium paid for such policies as indicated in the schedule below, unless by reason of special, direct or reinsurance contracts or treaties entered into whereby a return of the unabsorbed premium shall be other than the indicated percentage of the premium paid for such policies shown in the schedule:

Inland Marine	15%
Automobile	20%
Lumber and Woodworking Risks	20%
All Other	25%

The following are extracted from the by-laws of the company:

Article 11. (1) Participating policyholders of this company shall participate in the earnings in such manner and to such an extent as may be determined by the Board of Directors in its absolute discretion from time to time. The action of the Board of Directors in the distribution of unabsorbed premiums shall be conclusive and binding on the members of the company.

(2) For the purpose of determining unabsorbed premiums to participating policyholders, the business of the company may be divided into classifications, and unabsorbed premiums of varying amounts may be declared on each classification, or these unabsorbed premiums may be retained by the company in cases where the policy is cancelled at the request of the policyholder.

All policies issued in Canada are said to be participating policies. But I have been unable to find anything in exhibit 9 (which is a copy of fire policies issued in 1944) which would indicate that the policyholders are entitled as of right to a return of any part of the premium. The matter is entirely discretionary with the directors. It is apparent, also, that the directors, in determining what distribution is to be made, take into consideration the earnings from all sources, including income from very substantial reserves and surplus, as well as the operating loss or profit for the year in question. Mr. Millar stated that the "dividend" was paid out of the reserve which the company had built up over the years.

In 1944 there was a very substantial operating loss on business in Canada (as also in 1943) and it does not appear whether there was an operating surplus in the business in the United States. But a "dividend" of 25 per cent in respect of fire policies was declared for the entire year. In the resolution of the Board, as quoted above, it is to be noted that "there shall be returned to policyholders unabsorbed premiums or dividends at the percentage of the premiums paid for such policies".

"Rebates" is not defined in the Act. In the Shorter Oxford English Dictionary, second edition, it is defined as:

a reduction from a sum of money to be paid—a discount, also a repayment; to deduct (a certain amount from a sum); to subtract (one quantity or number from another); to reduce or diminish (a sum or amount).

In Law Dictionary (by English) it is defined as:

reduction in amount paid; return of a portion of money paid.

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In Words and Phrases, volume 36, p. 422, it is defined as:

> The word "rebate" is defined as an allowance by way of discount or drawback; a deduction from a gross amount; deduction, abatement, remission, or payment back, as, a rebate of interest for immediate payment; a rebate of freight charges; discount; the abatement of interest in consequence of prompt payment; an allowance by way of discount or drawback; deductions from stipulated premiums allowed in pursuance of antecedent contract. (*State* v. *Loucks* 228, P. 632, 634, 32 Wyo. 26.)

And in Words and Phrases, under the sub-heading "Insurance", it is defined as:

> In insurance rebates are deductions from stipulated premiums allowed in pursuance of antecedent contract. (*State* v. *Hybernia Insurance Co.* 38, La. Ann. 465, 467.)

I am of the opinion that "rebates" means a repayment and, as used in the section 13 (*f*), it must refer to payment back of a portion of premiums, for the only payment made by the policyholder was a premium. If that which the policyholder was paid represented only that portion of his premium not needed to cover losses and expenses during the currency of his policy, and if all policyholders received the same consideration, it might well be argued that the payment so made constituted a "rebate", and more particularly so if the payments were made pursuant to a pre-existing contract. But here the facts are quite different as I have indicated above. In 1944, in Canada at least, there was no operating surplus and what was paid to the policyholder was paid only after taking into consideration revenue from other sources, including income from surplus and reserves to which many of the policyholders who received the payment in 1944 contributed little, if anything. What that policyholder received was, I think, a dividend. As pointed out by Mr. Millar, the Board set up a voluntary reserve for dividends and it was out of that fund that the payments to policyholders were made. Mr. Millar used the word dividend throughout that part of his evidence which I have quoted, and I think rightly so.

I have not been referred to any case in Canada in which the words "rebate" or "dividend", as related to insurance premiums, have been defined. The word "dividend", how-

ever, was considered in *New England Mutual Life Insurance Company* v. *Reece* (1), in the Supreme Court of Tennessee. In the headnote to that case it states:

> "Dividend" in insurance terminology does not represent a bare share of corporate profit, apportioned to a stockholder, but is a share of surplus allocated to a policyholder which represents a return of a portion of the premium not needed to meet losses and expenses and may include a distribution of earnings

There is no question but that in the year 1944 that which the policyholders received consisted to a very substantial extent of a distribution of earnings. In my view, therefore, what they received was a dividend and I find, therefore, that the sum of $19,502.82 paid by the defendant in that year was not a rebate but a dividend, and that the defendant was therefore not entitled to deduct it from its gross premiums.

Counsel for the defendant points out that from 1932 to 1943 the defendant claimed deductions under the heading, "rebates and returned premiums", in respect of the same type of payments and that no objection was taken thereto by the Superintendent of Insurance, until 1944. He contends that as the Superintendent has, by his actions, approved of such deductions, and that as (in his opinion) the section does not clearly exclude such an interpretation favourable to the defendant, that therefore the Crown is bound by such an interpretation made by one of its officers over a long period of time.

It is shown that in June, 1944, the Superintendent wrote the defendant, pointing out that Part 3 of the Act did not permit deductions from gross premiums of dividends paid or credited to policyholders for the purpose of arriving at the net premiums taxable thereunder. He stated that, doubtless through oversight on the part of the company, it had taken credit for such dividends in the years 1932 to 1943 and, through oversight on the part of the officers of the Department, such deductions had been allowed without demand for further payment. He requested payment of the arrears of $4,193.63. On December 27, 1944, however, the Superintendent notified the defendant that the arrears had been remitted by Order in

(1) (1935) 83 S.W.(2d) 238.

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Council for the years 1932 to 1943, and that the tax on such dividends would become payable for 1944 and subsequent years.

I cannot, however, find that the plaintiff is bound by the occurrences which I have outlined. There is nothing to indicate that the Superintendent had knowledge that the deductions for the period 1932 to 1943 were, in fact, dividends and not "rebates and returned premiums paid on the cancellation of policies", as provided for in the section. It may well have been the fact that the true nature of these payments was not brought to the attention of the Superintendent until 1944 and, in any event, in view of what I later find herein, namely, that the deductions are limited to payments made on cancellation of policies, it is clear that even if the Department had full knowledge of the nature of the payments in the years 1932 to 1943, the defendant was not entitled to such deductions inasmuch as they were not paid to policyholders on cancellation of policies.

I have endeavoured to deal fully with the argument advanced by counsel for the defendant as I understand that this is in the nature of a test case. The solution to the problem could be reached, I think, without the necessity of considering all the matters to which I have referred above. In my view, the meaning of this part of the section is clear. I am of the opinion that the only deductions which may be made by the company from its net premiums, as authorized by section 13 (*f*), are those monies returned to policyholders upon the cancellation of the policies, either by the insured or by the insurer, provision for which is made in the standard conditions attached to the policy. In my view the words, "paid on the cancellation of policies", relate not only to "returned premiums" but also to "rebates". For the defendant it is argued that "rebates" has a meaning quite distinct from "returned premiums", and that the payments made by it in 1944 are "rebates" which may be deducted from the gross premiums, although admittedly they are not paid on the cancellation of policies. With that contention I cannot agree. In my view there is no material distinction between the word "rebates" and

"returned premiums". Both, in the manner in which they are here used, referring to a payment back of part or all of premiums received, refer to the same thing. Excluding claims for losses, there are only two ways in which, so far as I am aware, payments could be made to policyholders: (1) by return of premiums or; (2) by way of dividends. It is to be noted that in the first part of the section relating to life insurance companies, both are allowed as deductions and that they are named separately by use of the words, "*less* premiums returned", and "*less* the cash value of dividends". If it had been the intention to permit the defendant company and other similar companies to deduct "dividends", it would have been a simple matter to include them in the same group as the life insurance companies or, alternatively, in that part of the section applicable to them to permit the deduction of "the cash value of dividends paid or credited to policyholders".

Nor could it be successfully argued, I think, that the intent of the section was in all cases to levy the tax only on the net cost of the insurance to the insured. That is the case with mutual companies carrying on the business on the premium deposit plan, and for "exchanges". To uphold the argument advanced by the defendant would be to place the defendant company and similar ones in the same category as "exchanges" and mutual companies carrying on business on the premium deposit plan, and there would have been no necessity of having a special definition of "net premiums" for companies like the defendant, falling into the category of "any other company".

It follows, therefore, that should the payments made by the defendant be, in fact, "rebates" and not dividends as I have found, as they were not paid "on the cancellation of policies" they cannot be deducted.

The plaintiff is therefore entitled to succeed. There will be judgment for the plaintiff against the defendant for the sum of $585.08 and costs to be taxed.

Judgment accordingly.