Insurance pools as taxable entities

Category: Opinion 14 June 2017
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Are insurance pools taxable under the NIRC? This issue was tackled in the case of *AFISCO Insurance Corporation et al. v. Court of Appeals, et al*. (G.R. No. 112675, January 25, 1999). Justice Artemio Panganiban summed-up the issue of the case as follows: "a number of local insurance firms formed themselves into a pool in order to facilitate the handling of business contracted with a non-resident foreign reinsurance company. May the clearing house or insurance pool so formed be deemed a partnership or an association that is taxable as a corporation under the National Internal Revenue Code (NIRC)? Should the pool's remittances to the member companies and to the said foreign firm be taxable as dividends?"

A group of 41 non-life insurance companies, as ceding companies (assessed as "Pool of Machinery Insurers"), entered into a Pool Agreement or an association that would handle all the insurance business covered under their quota-share reinsurance treaty and surplus reinsurance treaty with Munich. Specifically, "upon issuance by them of Erection, Machinery Breakdown, Boiler Explosion and Contractors All Risk insurance policies, the petitioners on August 1, 1965 entered into a Quota Share Reinsurance Treaty and a Surplus Reinsurance Treaty with the Munchener Ruckversicherungs-Gesselschaft (hereafter called Munich), a non-resident foreign insurance corporation. The reinsurance treaties required petitioners to form a [p]ool. Accordingly, a pool composed of the petitioners was formed on the same day."

SUPREME COURT RULING

The Supreme Court ruled that the insurance pool was a partnership taxable as a corporation, and that the latter's collection of premiums on behalf of its members, the ceding companies, was taxable income.

An insurance pool is an informal partnership taxable as a corporation under the NIRC. The pool is a taxable entity distinct from the individual corporate entities of the ceding companies. The tax on its income is different from the tax on the dividends received by the said companies.

The Court ruled that a taxable partnership or association covered by Section 24 of the NIRC was formed in view of the following indicators: (1) The pool has a common fund, consisting of money and other valuables that are deposited in the name and credit of the pool. This common fund pays for the administration and operation expenses of the pool; (2) The pool functions through an executive board, which resembles the board of directors of a corporation, composed of one representative for each of the ceding companies; and (3) True, the pool itself is not a reinsurer and does not issue any insurance policy; however, its work is indispensable, beneficial and economically useful to the business of the ceding companies and Munich, because without it they would not have received their premiums. The ceding companies share in the business ceded to the pool and in the expenses according to a Rules of Distribution annexed to the Pool Agreement. Profit motive or business is, therefore, the primordial reason for the pools formation.

The Supreme Court ruled that "(i)neludibly, the Philippine legislature included in the concept of corporations those entities that resembled them such as unregistered partnerships and associations. Parenthetically, the NIRCs inclusion of such entities in the tax on corporations was made even clearer by the Tax Reform Act of 1997, which amended the Tax Code."

Citing the CTA (CTA Case No. 5039, October 19, 1992), "the fact that the pool does not retain any profit or income does not obliterate an antecedent fact, that of the pool being used in the transaction of business for profit. It is apparent, and petitioners admit, that their association or coaction was indispensable [to] the transaction of the business. x x x If together they have conducted business, profit must have been the object as, indeed, profit was earned. Though the profit was apportioned among the members, this is only a matter of consequence, as it implies that profit actually resulted."

The Court ruled that the remittances of the pool to the ceding companies and Munich are taxable dividends. The Court ruled that "Section 255 provides that no tax shall xxx be paid upon reinsurance by any company that has already paid the tax xxx. This cannot be applied to the present case because, as previously discussed, the pool is a taxable entity distinct from the ceding companies; therefore, the latter cannot individually claim the income tax paid by the former as their own."

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