

September 12, 1928.

OPINION No. 1500.

TAXATION — CORPORATIONS—INSURANCE COMPANIES — INCOME TAX, ASSESSMENT OF, UPON DIVIDENDS PAID BY INSURANCE COMPANIES:

Dividends paid to their stockholders by insurance companies (which companies, under Section 3473, Revised Laws of Hawaii, 1925, are taxed on a percentage of their premiums) are not exempt from assessment of income taxes thereon under the last paragraph of Section 1391, R. L. 1925, and should be included in assessing the income of the persons receiving such dividends, such companies not being corporations upon the "net profits" of which a tax has been assessed "as required by this chapter" (Chap. 103, R. L. 1925). within the meaning of the last paragraph of Section 1391, R. L. 1925.

Honorable Henry C. Hapai,
Treasurer, Territory of Hawaii.
Honolulu, T. H.

Dear Sir:

A firm of Honolulu attorneys, on behalf of the Home Insurance Company, Ltd., a domestic corporation, has taken up with this office the question as to whether stockholders of insurance companies may deduct the dividends received by them from such companies in their income tax returns. This office deems the question to be of sufficient importance to warrant a more extended consideration of the point than was given it in tile letter of the former Attorney General to you under date of January 18, 1928.

The income tax on corporations is provided for in Section 1389, R. L. 1925, which provides that "there shall

be levied, assessed, collected and paid annually, *except as hereinafter provided*, a tax of five per centum on the net profit or income * * * of all corporations * * * provided, however, that nothing herein contained shall apply to * * * nor to insurance companies taxed on a percentage of the premiums under the authority of another law. "

Turning to Section 3473, R. L. 1925, we find the following provision with respect to insurance companies:

"* * * * All insurance companies or corporations except life insurance companies shall pay to the treasurer, through the insurance commissioner, a tax of two per centum on the gross premiums received from all risks located in, and from all business done within the Territory, during the year ending on the preceding 31st day of December, less return premiums, re-insurance in companies or corporations authorized to do business In the Territory when the re-insurance is placed through or with local agents; and all life insurance companies shall pay to the treasurer, through the insurance commissioner, a tax of two per centum on the gross premiums received from all business done within the Territory, during the year ending on the preceding 31st day of December, less return premiums, re-insurance in companies or corporations authorized to do business in the Territory, when the re-insurance is placed through or with local agents, and operating and business expenses, which taxes, when paid shall be in settlement of all the demands of taxes, licenses or fees of every character imposed by the laws of the Territory, excepting property taxes, and the fees set forth in Section 3472 for conducting the business of insurance in the Territory."

In the section last quoted we find the provisions which are referred to in the last clause of the proviso of Section 1389, first above quoted.

Section 1391, R. L. 1925, contains the following proviso:

"Provided, further, that in assessing the income of any person or corporation there shall not be included the amount received from any corporation as dividends upon the stock of such corporation if the tax of two per centum has been assessed upon the net profits of such corporation as required by this chapter, nor any bequest or inheritance otherwise taxed as such."

It will be noted that this proviso authorizing the non-inclusion of corporate dividends in tax returns is limited to dividends of corporations upon which has been levied the tax upon the “*net profits*” “*as required by this chapter,*” (that is, Chapter 103, R. L. 1925).

Insurance companies under the provisions of Section 1389, R. L. 1925, above quoted, are expressly excepted from the operation of the provisions of Chapter 103, R. L. 1925, so that they are not taxed “as required by this chapter.” Nor under the provisions of said Section 3473, above quoted, are insurance companies taxed on their “net profits,” the tax being upon the “gross premiums received,” less certain deductions. It seems quite clear then that insurance companies do not at all come within the definition of corporations whose dividends need not be included in income tax returns as set forth in the proviso of Section 1391, above quoted.

It will be noticed, however, that the above quoted proviso of Section 1391 refers to “the tax of *two* per centum” assessed upon the net profits of corporations “as required by this chapter,” and turning back to Section 1389, R. L. 1925, we find that the tax levied on corporate income under “this chapter” is *five* per centum and not two.

Counsel for the Home Insurance Company, Ltd., might raise the point as to whether or not the differences just noted create an ambiguity, and if so, whether the ambiguity is of such nature that it can and ought to be construed so as to bring the stockholders of insurance companies within the exemption contained in the above quoted proviso of Section 1391.

In considering this question it will be necessary to go into the history of the legislation on this subject. Section 1389, R. L. 1925, was originally Section 2 of Act 20, S. L., 1901, and became Section 1279, R. L. 1905, reading as follows:

“There shall be levied, assessed, collected and paid annually, except as hereinafter provided, a tax of TWO PER CENT on the net profit or income above actually operating and business expenses, from all property owned, and every business, trade, employment or vocation carried on in the Territory of Hawaii, of all corporations doing business for profit in the Territory, no matter where created and organized; provided, however, that nothing herein contained shall apply to corporations, companies or associations conducted solely for charitable, religious, educational or scientific purposes, including fraternal beneficiary societies, nor to insurance companies taxed on a percentage of the premiums under the authority of another Act.”

This was amended by Section 2 of Act 87, S. L. 1905, in respects not material to our question. Under this section in its original form, the tax levied on corporate incomes in general was *two* per cent. It will also be seen that the proviso of the original section is exactly the same word for word as that of the present Section 1389, R. L. 1925, with the exception of the last word; the last word of the former being “act,” and that of the latter being “law.”

Section 1391, R. L. 1925, was originally Section 4 of Act 20, S. L. 1901, and became Section 2181, R. L. 1905, the last paragraph thereof reading as follows:

“Provided, further that in assessing the income of any person or corporation there shall not be included the amount received from any corporation as dividends upon the stock of such corporation if the tax of two per cent has been assessed upon its net profits by said corporation as required by this Act, nor any bequest or inheritance otherwise taxed as such.”

It will be seen from a comparison of this proviso in the original section and the corresponding proviso in the present section 1391, R. L. 1925 (which was put in its present form by Act 157 S. L. 1917) that the two are almost identical in wording and are identical in effect. The reason now for the *two* per centum tax rate mentioned in the last proviso of Section 1391, R. L. 1925, in its present form, is clearly apparent—it was *placed there*

because the original tax levied on corporate incomes was also two per cent. This rate on corporate incomes was raised to five per cent by Section 2 of Act 163, S. L. 1921, which amended Section 1306, R. L. 1915 (Section 2, Act 20, S. L. 1901, R. L. 1905, Section 1279; as amended by Section 2, Act 87, S. L. 1905), but the Legislature, by oversight, obviously, failed to amend the last proviso of Section 1308, R. L. 1915 (Section 4, Act 20, S. L. 1901; R. L. 1905, Section 1281; as amended by Section 4, Act 87, S. L. 1905) so as to make the same conform to the increased tax rate on corporate incomes authorized by the amendment of the former section.

While, therefore, it would seem from a cursory examination of these two sections that there was an ambiguity in their terms, yet an examination of the history of this legislation makes the legislative intent perfectly clear, and there is, therefore, in fact, no real ambiguity between the two sections such as would justify us in construing the same, in the absence of other circumstances, in a different manner than we would have done before the amendment which raised the income tax rate on corporations from two to five per cent.

We are obliged, then, to fall back upon the construction of these two sections as they existed prior to the passage of Act 163, S. L. 1921 (which, as above mentioned, raised the income tax rate on corporations from two to five percent), in so far as they concern insurance companies. And, as I have already stated above, it is clear that, prior to the passage of said Act 163, S. L. 1921, "insurance companies taxed on a percentage of the premiums under the authority of another law" did not come within the definition of corporations whose dividends need not be included in income tax returns of those receiving them under the proviso contained in the last paragraph of what is now Section 1391, R. L. 1925.

In this connection this office disagrees entirely with

the statement hereinafter underlined, contained in the letter of counsel for the Home Insurance Company, Ltd., dated September 5, 1928, to the effect that Section 3473, R. L. 1925, "was passed in 1917, and would certainly then have been construed as being a liquidation of a corporation income tax *which did not then specifically exempt insurance companies.*"

An examination of the history of what is now Section 1389, R. L. 1925, from the time of its original enactment as Section 2 of Act 20, S. L. 1901, to the present date, will disclose that this section has always contained a proviso exempting insurance companies taxed on a "percentage of the premiums under the authority of another law" from the payment of the corporation income tax. That being the case, insurance companies under Section 59, Act 115, S. L. 1917 (now Sections 3473, R. L. 1925) being taxed on a "percentage of the premiums under the authority of another law" came exactly within the exemption contained in the last clause of what is now Section 1389, R. L. 1925. There was therefore no ambiguity or conflict between the provisions of these two sections at the time said Section 59 of Act 115, S. L. 1917, was passed, as seems to be contended by counsel for the Home Insurance Company, Ltd., in their said letter.

There being, as just stated, no ambiguity between the two sections last discussed, the question might well be dropped here, but lest we seem to have overlooked the point, this office deems it proper to discuss the further question as to whether the Legislature really intended to exact the two per cent tax imposed by Section 3473, R. L. 1925, from insurance companies as an income tax under the guise of a tax on premiums, and really intended that the dividends of such insurance companies should therefore be exempted as in the case of dividends of other corporations taxed under the provisions of Section 1389, R. L. 1925.

There certainly is considerable doubt as to whether in the absence of express words in the statutes such an exemption in favor of stockholders of insurance companies could be implied. Assuming, however, but not deciding that such a construction would be possible if the Legislature really intended the tax on premiums of insurance companies as an income tax, the question arises as to whether there was such an intent on the part of the Legislature. And this again can be best decided by a consideration of the history of Section 3473, R. L. 1925. While this section was enacted as Section 59 of Act 115, S. L. 1917, nevertheless it will be apparent to anyone going into the earlier history of our Territorial insurance laws that said Section is almost identical with and was taken over from an earlier provision, Section 3361, R. L. 1915, which was in force until it was expressly repealed by Section 62 of said Act 115, S. L. 1917. In other words, Act 115, S. L. 1917, was merely a comprehensive re-enactment of the insurance laws of the Territory in an amended form.

A construction by the courts, therefore, of Section 3361, R. L. 1915, would obviously apply also with equal force to the re-enactment thereof as Section 59 of Act 115, S. L. 1917, in the absence of drastic changes in the provisions thereof (and as I have stated above, there were no such drastic changes). We may therefore properly refer to the case of *In Re Taxes C. Brewer & Co., Ltd.*, (1915) 23 Haw. 96, in which case, on page 98, the Court states that "the tax imposed by Section 3361, R. L. 1915, upon insurance companies or corporations, is not a property tax *nor an income tax*, nor is it in any sense analogous to either as argued by counsel for appellant." Again on page 100, the Court states, "The tax imposed by Section 3361, R. L. 1915, is an excise tax imposed on insurance companies or corporations, whether of domestic or foreign origin, for the privilege of doing business within the Territory."

There is, therefore, no ground whatsoever for the contention that the tax levied by Section 3473, R. L. 1925, is an income tax, and consequently it cannot be argued that income received by persons or corporations as dividends upon stock of insurance companies should not be taxed since, as above stated, no income tax has been levied upon the same income in the hands of the insurance companies.

Finally, it would not be amiss to point out that while corporations in general under Section 1389, R. L. 1925, are taxed upon their net profits or income, insurance companies are taxed only upon net premiums, leaving a considerable amount of income which is received by said companies exempt from the payment of any tax thereon. It should be further noted that the rate of taxation upon the net profits or income of corporations under Section 1389 is five per cent, whereas the rate upon net premiums of insurance companies is only two per cent. We find here abundant reasons for the action of the Legislature in not exempting from the payment of income tax thereon dividends of insurance companies when they come into the hands of their stockholders.

This office therefore re-affirms its former holding in its letter of January 18, 1928, above mentioned, to the effect that dividends paid to their stockholders by local insurance companies are subject to the payment of income tax thereon, and should be included in the income tax returns of such stockholders.

Respectfully,

C. NILS TAVARES,
Second Deputy Attorney General.

APPROVED:

H. R. HEWITT,
Attorney General.