

TERRITORY OF HAWAII  
DEPARTMENT OF THE ATTORNEY GENERAL  
HONOLULU

45  
October 2, 1939

OPINION NO. ~~1750~~ 1723

TAXATION: MUTUAL BENEFIT SOCIETIES:

An association subject to the provisions of Sections 6852 A to L inclusive, R. L. 1935, as amended, which receives fees and dues from members and engages to pay benefits in the form of payments of hospital bills and similar bills, in its nature is an insurance organization.

SAME: SAME:

Such a mutual benefit society is not a "fraternal beneficiary society" when it has no objects or activities other than provision of benefits in the event of sickness.

TAXATION: NET INCOME TAX:

A mutual benefit society subject to the provisions of Sections 6852 A to L inclusive, R. L. 1935, as amended, which is not also a fraternal beneficiary society, is subject to the net income tax imposed by Ch.65, R.L. 1935.

SALE: GROSS INCOME TAX:

Such a mutual benefit society, which is not also a fraternal benefit society, is liable to the gross income tax imposed by Act

141 (Ser. A-44) L. 1935.

SAME: SAME:

A corporation or association which is operated for the economic benefit of its shareholders or members is engaged in "business" within the meaning of that term as defined in Section 1 (7) of Act 141 (Ser. A-44) L. 1935.

WORDS AND PHRASES:

"Business" as defined in Section 1 (7) of Act 141 (Ser. A-44) L. 1935 includes the activities of a corporation or association operated for the economic benefit of its shareholders or members.

Honorable William Borthwick,  
Tax Commissioner,  
Territory of Hawaii,  
Honolulu, T. H.

Dear Sir:

You have inquired as to the tax liability of Hawaii Medical Service Association, with respect to the net income tax imposed by Chapter 65, R. L. 1935, and the gross income tax imposed by Act 141 (Ser. A-44) L. 1935.

From the constitution and by-laws of the Association, and from statements furnished by the Association, it appears that the Association is subject to the provisions of Sections 6852 A to L inclusive, R. L. 1935, as amended by Act 172 (Ser. D-137) L. 1935, Act 177 (Ser. D-142) L. 1937, and Act 209, L. 1939. The Association has complied therewith.

The objects and purposes of the Association, as stated in its Constitution are:

"To carry on an organization for the sole benefit of its members and not for profit; to make provision for the furnishing of medical, nursing and hospital service for its members in case of sickness, accident and disability; and the securing of members among such classes of persons as shall from time to time be decided by the Board of Directors and stated in the By-Laws of the Association as they may be amended from time to time."

The association states that its activities "consist of collecting monthly dues from its members and in return paying claims incurred by members on account of doctor, nursing and hospital bills."

The Association is governed by a Board of Directors who are elected by the members. The board has power to decide the terms upon which any person or classes of persons may be admitted as members. By the By-Laws, until the Board determines otherwise, membership is restricted to employees of the Department of Public Instruction, the University of Hawaii, and similar institutions, registered nurses, and employees of Social Agencies. Any person who signs an application for membership becomes a member upon issuance to him of a certificate of membership, after his application has been approved by the Board or by the manager of the Association.

Certificates of membership are of two types. One entitles the member to medical, surgical, hospital and nursing benefits,

and the other entitles the member to hospital care only. For the first type the membership dues are \$2.20 per month, subject to increase or decrease by the Board. For the second type, the dues are fixed by the Board. There is also an initiation fee of \$1.00. One year is the least term of membership permissible. Membership automatically is terminated for delinquency in payment of dues.

The benefits to which each member is entitled are those stated in his Certificate of membership, subject to alteration from time to time by the Board. Fraud in the application for membership works a forfeiture of benefits.

By Sec. 6852-A, R. L. 1935, as amended, the Association is exempt from the provisions of the insurance laws of the Territory, except as therein provided. Sections 6852 A to L inclusive, R. L. 1935 contain numerous provisions and safeguards, administered by the Insurance Commissioner, and designed to safeguard the payment of the benefits offered to members. An association such as is here involved is declared by the statute to be a mutual benefit society, and this is the term used throughout, although the title refers to "Mutual and Fraternal Benefit Societies." The law further provides that such an association "shall be deemed to be a fiduciary company within the meaning of Section 6758"

and that it shall comply with the provisions of Chapter 221, R. L. 1935, relating to fiduciary companies.

Although the requirements imposed upon the Association are those laid down in special sections of Ch. 224, R. L. 1935, and are those relating to fiduciary companies, and the Association is exempt from the general provisions of Ch. 224, R. L. 1935 governing insurance companies nevertheless the Association is subject to the control of the insurance commissioner. In its nature it is an insurance organization, since, in consideration of periodical contributions, it engages to pay the member a benefit upon the happening of a specified contingency. Citizens' Life Insurance Co. v. Commissioner, 128 Mich. 85, 87 N. W. 126; Atlantic Coast Line R. Co. v. U. S., 66 Ct. Cls. 378, 7 Am. Fed. Tax Rep. 8891, 8899; Commercial Travelers' Life and Accident Ass'n. v. Rodway, 235 Fed. 370, D. C. Ohio; State ex rel Graham v. Nichols, 78 Iowa 747, 41 N.W. 4

The Association is liable to the net income tax imposed by Ch. 65, R. L. 1935. That law provides that the term "corporation" includes "associations", of which this association clearly is one. None of the exemptions from tax applies. Although "insurance companies exclusively taxable under the provisions of other laws" are exempt and this association in its nature is an insurance company, it is not

"exclusively taxable under the provisions of other laws" because that portion of the Insurance Law, section 6850, R.L. 1935, which so provides with respect to other insurance companies, does not apply to it. The only other exemption which could possibly apply is the exemption of "fraternal beneficiary societies." Although the statute with which the Association has complied does cover fraternal benefit societies, this Association is not one of them. It is strictly a mutual benefit society. The distinction is to be found in such cases as Commercial Travelers' Life and Accident Ass'n. v. Rodway, supra, and in Appeal of Philadelphia and Reading Relief Association, 4 B. T. A. 713. In the first of these cases the court says:

"\* \* \* the plaintiff is not a 'fraternal beneficiary society.'

"It seems very plain that Congress, in using this expression, did not intend to include within its operation a mutual protective association, such as plaintiff is. A mutual protective association, operating as plaintiff does, is nothing different from a mutual insurance company. A fraternal beneficiary association may be a mutual insurance company, and must be something more.\*\*\*"

\* \* \*

"Defining the words 'fraternal beneficial' as used in the Missouri Revised Statutes of 1889, Judge Thayer in National Union v. Marlow, supra, 74 Fed. on page 778, 21 C. C. A. 92, says:

"'It is noteworthy that, while the phrase "fraternal beneficial" is used in the connection above shown to designate a particular kind of societies or asso-

ciations that may be incorporated, yet it was not thought necessary to otherwise define the descriptive phrase thus employed. We must accordingly assume that the words "fraternal beneficial" were used in their ordinary sense -- to designate an association or society that is engaged in some work that is of a fraternal and beneficial character. According to this view, a fraternal beneficial society, within the purview of the Missouri statute, would be one whose members have adopted the same, or a very similar, calling, avocation, or profession, or who are working in unison to accomplish some worthy object, and who for that reason have banded themselves together as an association or society to aid and assist one another, and to promote the common cause. The term "fraternal" can properly be applied to such an association, for the reason that the pursuit of a common object, calling, or profession usually has a tendency to create a brotherly feeling among those who are thus engaged. It is a well-known fact that there are at the present time many voluntary or incorporated societies which are made up exclusively of persons who are engaged in the same avocation. As a general rule such associations have been formed for the purpose of promoting the social, moral, and intellectual welfare of the members of such associations, and their families, as well as for advancing their interests in other ways and in other respects.'"

And in the Board of Tax Appeals case it is said:

"\* \* \* The absence of profit in the operation of the association, a point upon which petitioner so strongly relies, is not the criterion, but the want of a fraternal side and object which it is in some measure organized to promote. Commercial Travelers' Life & Accident Association v. Rodway, 235 Fed. 370."

\* \* \*

"\* \* \* we are unable to discover, even in a remote degree, a single fraternalistic feature in its organization. It is entirely without any social features. Its membership is made up of individuals whose vocations are as numerous and diverse as the classifications of employment of a great railway system; \* \* \* all are entitled to membership in the Association for the mere asking, expressed in written application, provided no disability exists; and yet none of these look to the petitioner for any betterment in social and laboring conditions. There is

no fraternal object which moves them to seek membership in the Association, but rather the motive is mercenary. \* \* \*

The Association also is liable to the gross income tax imposed by Act 141 (Ser. A-44) L. 1935. It conducts an insurance business but is not one of the "insurance companies which pay the Territory of Hawaii a tax upon their gross premiums under the provisions of the Revised Laws of Hawaii 1935, chapter 224", and hence is not exempted by Sec. 4 (1) (e) of the Act. "Cooperative associations" are exempt, but only those incorporated under Ch. 220, R. L. 1935 (Sec. 4 (1) (j)). As previously noted this association is not exempt as a fraternal benefit society (Sec. 4 (1) (f)).

We already have given our opinion that a corporation which is operated for the economic benefit of its shareholders, though accumulating no profit, is engaged in "business" within the definition thereof in Section 1 (7), Act 141 (Ser. A-44) L. 1935. See Op. Att'y. Gen (1939) No. 1728. The same is necessarily true of this association.

In Peninsula Light Co. v. Tax Commission, 185 Wash. 669, 56 Pac. 2d, 720, it was held that a company buying electric power wholesale and distributing it to its constituent members at cost, was engaged in "business" within the meaning of the statutory definition that 'business' shall include all activities engaged in with the object of gain, benefit or advantage either direct or indirect," the object



of the company's activities being at least indirect pecuniary benefit.

In Farmers Oil Co. v. State Tax Commission, 41 N. W. 693, 73 Pac. 2d, 816, under a similar definition of "business" it was held that a cooperative association engaged solely in the distribution of gasoline and like commodities to its members, on a cooperative basis, at cost, was taxable, the court saying:

"While ordinarily the major purpose of corporate organization and management is profit to the corporation as an entity in the first instance, we know from experience and observation that the profit earned is destined for the stockholders in the form of dividends. In fine, therefore, the ordinary corporation organizes and engages in business for the pecuniary advantage of its stockholders. Do plaintiff's organization and activities appear to be for some other purpose? We think not."

Sanitary Milk and Ice Cream Co. v. Hickman, 119 W. Va. 35 193 S. E. 553, upholds the West Virginia gross income tax as applied to a cooperative engaged in processing and marketing the dairy products of its members, for the purpose of obtaining for them a greater return than they could obtain from the raw products. In State ex rel Dawson v. Sessions, 95 Kan. 272, 147 Pac. 789, 791, despite the exemption of "corporations which are not organized or operated for pecuniary profit which are not doing business for pay," a corporation maintaining a line of wires connecting with a telephone exchange, and another corporation maintaining an irrigation system, were held taxable,

although what they did was "the same as though the corporation required the members to pay for the use of the wires or the water, making the charge just enough to meet the expenses of maintenance." These cases all hold that a corporation or association operated for the advantage of its shareholders or members, is operated with the object of gain or benefit. This is sufficient under the statutory definition of "business" as including" all activities, (personal, professional or corporate) engaged in or caused to be engaged in with the object of gain or economic benefit either direct or indirect\* \* \*" (Act 141 (Ser. A-44) L. 1935, Sec. 1 (7)).

Respectfully,

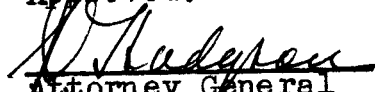


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