1952
*Nov. 13, 14, 17
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*April 15

STANLEY MUTUAL FIRE INSURANCE COMPANY (RESPONDENT).. } APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE (APPELLANT)..... } RESPONDENT.

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Revenue—Income—Mutual Insurance Company—Surplus arising from transactions with members transferred to reserve fund—Whether assessable—Income War Tax Act, R.S.C. 1927, c. 94, ss. 3(1), 6(1) (d) —New Brunswick Companies Act, R.S.N.B., 1927, c. 88, Part II,— Insurance Act, 1937 (N.B.), c. 44, ss. 2(40), (48), 249, The Winding-Up Act, R.S.N.B., 1927, c. 97.

The appellant was incorporated as a provincial mutual company under *The New Brunswick Companies Act,* R.S.N.B., 1927, c. 88, as amended by S. of N.B., 1937, c. 19, to undertake contracts of insurance against loss by fire etc., upon farm and other non-harzardous property upon the premium note plan subject to the provisions of Part II of the Act and of *The Insurance Act, 1937,* c. 44. Insurance was issued upon premium notes upon which a cash payment was secured prior to the issuance of the policy and the notes were subject to further assessments to meet losses and expenses incurred during the term of the policy. Where the amount collected in cash exceeded the current year's losses and expenses the surplus became part of the reserve fund. In 1947 the appellant transferred, as provided by s. 249 of the *Insurance Act,* a surplus of $6,103.69 to its reserve fund. This amount was assessed under s. 3(1) of *The Income War Tax Act,* R.S.C., 1927, c. 97, as amended, as taxable income, constituting an annual net profit or gain.

*PRESENT: Rinfret C.J., and Taschereau, Estey, Locke and Cartwright JJ.

Held: The surplus was accumulated as directed by *The Insurance Act, 1937* not in pursuance of a profit making enterprise but in furtherance of a mutual insurance plan carried on by the appellant in the interest of its members and the fund could not be applied, except on the order of the Governor in Council, to any purpose other than the settlement of claims or other liabilities. On a winding-up the surplus, if any, under the provisions of *The Winding-Up Act* (R.S.N.B. 1927, c. 97) and *The Insurance Act, 1937* read together, would be returned to the members of the Company. The moneys so accumulated were not income within the meaning of s. 3(1) of *The Income War Tax Act. Jones* v. *South West Lancashire Coal Owners Association* [1927] 1 K.B. 33 and *Ayrshire Employees Mutual Association Ltd.* v. *Commissioners of Inland Revenue* [1946] 1 All E.R. 637.

Decision of the Exchequer Court 1951 Ex. C.R. 341, reversed.

APPEAL from a judgment of the Exchequer Court of Canada, Hyndman Deputy Judge (1), allowing an appeal from a decision of the Income Tax Appeal Board (2) which allowed taxpayer's appeal from assessment for income tax for 1947.

W. B. Francis, Q.C. and *D. E. Gauley,* for appellant.

D. W. Mundell, Q.C. and *F. J. Cross,* for respondent.

The judgment of the Chief Justice, Estey, Locke and Cartwright, JJ. was delivered by:

LOCKE J.:—This is an appeal from a judgment of Hyndman D.J. delivered in the Exchequer Court (1) allowing the appeal of the Minister from a decision of the Income Tax Appeal Board, which had allowed the appeal of the taxpayer from an assessment to income tax for the year 1947.

The appellant is incorporated by letters patent under the provisions of Part II of *The New Brunswick Companies Act* (R.S.N.B. 1927, c. 88, as amended) issued in the year 1937. By these letters patent the applicants, all of whom were farmers living in that province, were created a body corporate and politic with all the rights and powers given by Part II of the said Act and *The Insurance Act, 1937* (c. 44: S. of N.B., 1937). The purposes of the company are stated to be:

> To undertake contracts of insurance against loss by fire, lightning or explosion upon farm and other non-hazardous property upon the premium note plan, subject to the provisions of Part II of the "New Brunswick Companies Act and the Insurance Act 1937."

(1) [1951] Ex. C.R. 341. (2) (1950) 3 Tax A.B.C. 96.

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The company has no capital stock.

The Companies Act of the Province, as enacted in the Revised Statutes of 1927, was amended by the addition of Part II by c. 19 of the Statutes of 1937. Ss. 129 to 153 of the amendment under the heading "Provincial Mutual Insurance Companies" provide for the incorporation of such companies. Companies incorporated under this Part have no shares but each person, partnership or corporation insured under a policy is declared to be a member thereof. Any five or more persons residents of and owning real estate in any county in the province may apply to the Superintendent of Insurance appointed under the provisions of *The Insurance Act, 1937,* for his approval to promote the organization of such a company and, with his approval, organization may be undertaken. After insurance has been subscribed by fifty or more subscribers to an amount not less than $100,000, the promoters may call an organization meeting and, if so authorized, petition the Provincial Secretary Treasurer for incorporation under a name which must include the words "Mutual Fire Insurance Company." Each subscriber to the subscription book for the organization of the company is required, within three weeks from the date of the incorporation or such further period as may be allowed by the Superintendent, to apply for a contract of insurance in an amount not less than the amount subscribed for by him, and is subject to a penalty for failure to do so. Each member not being in default for any dues, fees or assessments is entitled to one vote at all meetings which he attends. The directors must be members of the company in good standing and insured by it for at least $1,000 or be an accredited representative of a partnership or corporation, being a member in good standing insured for at least that amount. Companies so incorporated are empowered to make by-laws not inconsistent with the Act or *The Insurance Act, 1937* or the Regulations, for the management of its business, regarding the regulation of the tariff of fees, the levying of assessments and the forms, terms and conditions of its insurance policies, and generally for all matters incident to its incorporation or necessary for carrying out its purposes, but no such by-law is of any force or effect until the same is approved by the Superintendent. His approval is likewise required to the

alteration, repeal or re-enactment of any of the by-laws. By-laws passed by the Board of Directors may also be enacted but become effective only with approval of the Superintendent. S. 142 provides that any member may, with the consent of the directors, withdraw from the company upon such terms as the directors may lawfully prescribe, and upon such withdrawal his policy shall be cancelled but he shall nevertheless be liable to be assessed for and pay his proportion of "losses, expenses and reserve" to the time of cancelling the policy.

The Insurance Act of 1937 deals with the subject of insurance in all its branches within the province and Part XII under the heading "Provincial Mutual Insurance Companies" by ss. 226 to 249, both inclusive, deals particularly with the operation of such companies. S. 129 of Part II of the Companies Act provides that the word "company" in that part shall mean a "provincial mutual company" as defined in s. 2 of the Insurance Act, which defines such a company as meaning a mutual insurance corporation incorporated by or under an Act of the Legislature. S-s. 40 of s. 2 of the Insurance Act reads:—

MUTUAL INSURANCE

Mutual insurance means a contract of insurance, in which the consideration is not fixed or certain at the time the contract is made but is to be determined at the termination of the contract or at fixed periods during the term of the contract according to the experience of the insurer in respect of all similar contracts whether or not the maximum amount of such consideration is predetermined.

The word "member" where used in Part XII is defined as meaning a person holding a contract of insurance from a provincial mutual insurance company. Such companies are prohibited from undertaking any risk in respect of any one property or risk subject to the hazard of a single fire, for an amount greater than $3,000 unless it be reinsured to an amount sufficient to reduce the net liability of the insurer to that amount. However, with permission of the Governor in Council, risks not exceeding $5,000 may be undertaken. The form, terms and conditions of the applications and policies of insurance are to be determined by the Board of Directors but are subject to the approval of the Superintendent. Each application and policy is required to bear the words

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Mutual company—subject to pro rata distribution of assets and losses.

together with a statement of the company's total reserves as of the preceding 31st of December. The Board may, subject to the provisions of the Act and with the approval of the Superintendent, adopt a "tariff of rates for premium notes" and vary the same from time to time. A company may accept premium notes for insurance and may issue policies thereon and such notes must be assessed for the losses and expenses of the insurer in the manner provided by the Act. The form of such notes must be approved by the Superintendent. The Board is required to demand and collect a cash payment on the note at the time of the application for the insurance of such amount as may be fixed by by-law and if the amount so collected in cash is more than sufficient to pay any losses and expenses during the maintenance of the policy, any surplus becomes part of the reserve fund. The Board is further authorized to make assessments upon premium notes before losses have happened or expenses been incurred and any surplus from any such assessment becomes part of the reserve fund. All assessments on premium notes are required to be made by the Board with the approval of the Superintendent, such assessments to be made at such intervals and of such sums as the Board determines and the Superintendent approves to be necessary to meet losses, expenses and reserve of the insurer during the currency of the policies on which the notes were given. If any assessment in respect of a policy be not paid within thirty days after the mailing of the notice of assessment, the policy becomes null and void as against the insured as to any claim for losses occurring during the time the policy holder is in default. If the policy be cancelled or avoided by the company, the liability of the insured on his premium note ceases from the date of such cancellation or avoidance in respect of any loss that occurs thereafter, but the insured shall nevertheless be liable to pay his proportion of the losses and expenses of the insurer up to that time and, upon payment of his proportion of all assessments then payable or to become payable in respect of losses and expenses sustained up to that time, he shall be entitled to a return of his premium note. The limit of the liability of the member under the premium note plan is the face amount of the note.

Under the sub-heading "Reserve and Guarantee Fund" s. 249 provides:—

249. (1) The insurer shall form a reserve fund to consist of all money which remains on hand at the end of each year after payment of expenses and losses; and in addition shall levy an annual assessment, not exceeding twenty-five per centum, and not less than five per centum, on the premium notes held by the insurer until such reserve reaches the sum of five hundred dollars for every one hundred thousand dollars of the first one million dollars insurance in force, and three thousand dollars for each additional one million dollars or part thereof in force, up to which minimum level it shall be maintained, and for such purpose the insurer shall thereafter levy annually such adequate assessment as the Superintendent approves.

(2) Such reserve fund may, from time to time, be applied by the board to pay off such liabilities of the insurer as are not provided for out of the ordinary receipts for the same or any succeeding year.

(3) 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 fund 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.

S. 61 of the Act permits an insurer to invest its reserve in securities in which trustees are by law permitted to invest trust funds, with a limitation as to the amount permitted to be invested in mortgages on land and requires that uninvested funds shall be kept on deposit in the name of the insurer in a post office, provincial savings bank or chartered bank of Canada.

The by-laws adopted by the company state that:—

The object of the company is a mutual association of the members thereof for the relief of each other in case of loss by fire or lightning.

They provide that the company may insure against loss or damage by fire or lightning isolated dwelling houses, farm buildings, churches and school houses and any other useful isolated non-hazardous buildings and the ordinary contents of such buildings when situate within the Province of New Brunswick, but shall not insure mercantile risks. No property may be insured for more than two-thirds of its value. Each person insuring for the first time is required to pay a Membership Fee of $1. Schedules of rates on all isolated buildings 100 feet distant from all others not part of the premises, with their contents, are fixed at a premium note of 2 per cent of the amount of the policy for three years with a cash payment thereon of one-half of the amount after discount, if any, has been

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allowed. On public halls with their contents and rented buildings of the first class 100 feet distant from all others not part of the premises, the rates are fixed at a premium note of 2½ per cent with a cash payment of one-half of that amount, less any discount.

The balance sheet of the appellant company for the year ending December 31, 1947, shows its assets to consist of bonds to the value of $37,000, accrued bond interest $319.98, cash to the amount of $4,936.01 and stirrup pumps valued at $220. As against this, liabilities in respect of unearned premiums are shown as being $19,824.51, an amount classified as Reserve Fund $6,103.69 and a further amount as Surplus in the sum of $16,557.79.

The profit and loss account for the year shows income totalling $16,050.27 made up of premiums earned, membership fees, interest and an item designated "Special Permits". The expenses totalled $9,946.50, this including fire losses of $6,838 agents' fees and commissions $1,671.87, the balance being made up of salaries, directors' fees, printing and stationery and other incidental expenses. The excess of receipts, including premiums earned, over the disbursements was $6,103.69, which amount was transferred to the Reserve Fund pursuant to the provisions of s. 249 of the Provincial Insurance Act.

No question arises regarding the interest earned upon the company's investment of its reserve fund which is conceded to be taxable. The dispute is as to the balance on hand at the end of the year's operations resulting from the fact that the cash premium receipts and the amounts assessed upon the premium notes exceeded the outgoings for losses and other necessary expenses.

The appellant was assessed to income tax upon $6,103.69, the amount transferred to the reserve fund, and on the taxpayer filing a notice of objection the Minister affirmed the assessment. The appeal to the Income Tax Appeal Board was allowed. Mr. Justice Graham, with whom Mr. Fabio Monet, Q.C. agreed, considered that the operations of the company did not result in any profit and that the surplus resulting from the year's operations was not income, within the meaning of that term as defined by s-s. 1 of s. 3

of the *Income War Tax Act*, as amended, other than the amount received from bond interest. Mr. W. S. Fisher, Q.C., the third member of the Board, dissented.

The appeal of the Minister to the Exchequer Court was allowed. Mr. Justice Hyndman considered that the company was not in essence a genuine mutual company, as defined by the authorities, being of the opinion that the essential feature of such concerns was that the contributors to the funds must also be participators in the surplus, and that this was excluded in the present matter by s-s. 3 of s. 249 of the Insurance Act. The learned trial Judge concluded that there was no real distinction between the appellant company and any ordinary fire insurance company and that the surplus must be regarded as a profit or gain to it and not to the members.

S-s. 1 of s. 3 of the *Income War Tax Act*, in so far as it affects the present matter, reads:—

> For the purposes of this Act "income" means the annual net profit or gain . . . being profits from a trade or commercial or financial or other business or calling . . . and shall include the interest, dividends or profits directly or indirectly received from money at interest upon any security or without security or from stocks or from any other investment, and whether such gains or profits are divided or distributed or not.

The question is whether the surplus resulting from the amounts received from premiums paid in cash at the time the insurance is effected and from assessments being in excess of that required for the company's operations is a profit or gain. For the Minister the contention is that accepted by Mr. Justice Hyndman that by the very terms of the Insurance Act the reserve fund is the property of the company and not of its members: accordingly since its receipts for the year have exceeded its expenditures the balance remaining is, of necessity, a profit or gain to the company since its assets have been increased to that extent.

The question of the liability to income tax of the surplus funds of mutual insurance companies has been considered in several cases in England. In *New York Life Insurance Company* v. *Styles* (1), the question of the liability of such a fund resulting from payments of premiums by the participating shareholders of the company was considered. The company had no shares or shareholders, the only

(1) (1889) 14 App. Cas. 381.

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members being the holders of participating policies, each of whom was entitled to a share of the assets and liable to all losses. A calculation was made by the company of the probable death rate among the members and of probable expenses and other liabilities and the premiums charged were commensurate therewith. Annually an account was taken and the greater part of the surplus of such premiums over expenditures was returned to the policy holders as bonuses, either by addition to the sums insured or in reduction of future premiums and the remainder of the surplus was carried forward as funds in hand to the credit of the general body of the members. It was conceded that the income derived by the company from investments and from transactions with persons not members was assessable. It was held that no part of the premium income received under participating policies was liable to be assessed to income tax. The case, on the face of it, is distinguishable from the present in that the entire surplus resulting annually from the transactions of the company with participating shareholders was either returned to them, utilized for their benefit by increasing the amount of the insurance, or held for their benefit, to be accounted for thereafter. That an operation of this nature was mutual insurance could not be questioned. Lord Watson, speaking of the plan, said (pp. 393-4):—

> The individuals insured and those associated for the purpose of receiving their dividends, and meeting policies when they fall in, are identical; and I do not think that their complete identity can be destroyed, or even impaired, by their incorporation. The corporation is merely a legal entity which represents the aggregate of its members; and the members of the appellant company are its participating policy-holders.
>
> 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 . . . 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.

Lord Bramwell, who was of the same opinion, said in part (pp. 394-5):—

> The appellants do not carry on a profession, trade, employment, or vocation from which profits or gains arise or accrue within the meaning of the Income Tax Act . . . I speak, of course, of the mutual insurance business. They are a corporation, but the case may be, as is admitted, dealt with as though they were an unincorporated association of individuals. Take it that they were; take it that half-a-dozen persons so associated themselves at the beginning of the year; they each put into a common purse £10, to be given to the executors of any one who dies, or divided, if more than one dies, among the executors of those having died. In fact, no one dies, and the money is returned, or carried on for the next year. Is it possible to say that this is an association for the purpose of profit, or that it has made any profit?

Lord Herschell, after referring to the fact that the Attorney-General had conceded that the fact that the persons thus associating themselves together for the purpose of mutual insurance had been incorporated was immaterial and that the case might be treated as though it were an association of individuals unincorporated, said that persons who agree to contribute to a common fund for mutual insurance would not in ordinary parlance be regarded as carrying on a trade or vocation for the purpose of earning profit, and continuing (pp. 409-10):—

> Let us see how the so-called profit arises. It is due to the premiums which the members are required to pay being in excess of what is necessary to provide for the requisite payments to be made upon the deaths of members, and not being, as the case states they were intended to be, commensurate therewith. This may result either from the contributions having, owing to an erroneous estimate or overcaution, been originally fixed at a higher rate than was necessary, or from the death rate being lower than was anticipated. Can it be properly said that, under these circumstances, the association of mutual insurers had earned a profit? The members contribute for a common object to a fund which is their common property; it turns out that they have contributed more than is needed, and therefore more than ought to have been contributed by them, for this object, and accordingly their next contribution is reduced by an amount equal to their proportion of this excess. I am at a loss to see how this can be considered as a "profit" arising or accruing to them from a trade or vocation which they carry on.

Lord Macnaghten who agreed that the surplus was not taxable was also of the opinion that the fact that the insured who were also the insurers carried on their business through the medium of a company had been properly treated as immaterial.

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In *Jones* v. *South West Lancashire Coal Owners' Association* (1), the manner of operation of the Association, whose liability to taxation was considered, more closely resembled those of the present appellant. A colliery company was a member of an Association, a company limited by guarantee, the sole activity of which was the indemnity of its members against compensation in respect of fatal accidents to their workmen. The Association was a mutual concern, every person indemnified by it being a member, and calls were made by it and paid by the members for insurance, and nothing more. Out of these calls a general fund was built up to meet claims for indemnity and a reserve fund was also created the interest earned upon which might be applied in diminution of the calls upon members. It is of importance to note that if a member retired from the Association he was entitled to receive back a proportion only of what was called his share of the reserve fund, the balance being retained. Rowlatt J., by whom the case was tried, held that the principle stated in the *New York Life* case was applicable. As to the reserve fund, he said (p. 47):—

> No doubt, as the money is not distributed year by year, and calls are not limited to actual losses, but to enable a fund to be built up, it may in a sense be said that the Association has a fund which it holds as a company and which it does not divide among all the people who have built it up, inasmuch as members may come in when the fund has been largely built up, and so there is a fund which does not go back to those people who subscribed it individually.

and, after saying that, in his opinion, this did not distinguish the case from the *New York Life* case, said (p. 48):—

> The broad principle was there laid down that, if the interest in the money does not go beyond the people or the class of people who subscribed it, then, just as there is no profit earned by the people subscribing, if they do the thing for themselves, so there is none if they get a company to do it for them.

This decision was upheld by the Court of Appeal and by the House of Lords. Two questions had been decided by Rowlatt J., the first being as to whether the colliery company was entitled to charge the amount of the levies made by the Association as an expense of its business and as to this he had decided that such payments were properly

(1) [1927] 1 K.B. 33.

deductible. In the reasons for his judgment on the appeal, Lord Hanworth M.R. said in part (p. 58):—

> It is said that once the first case is decided in the way it has been, that these moneys were absolutely paid over by the insured to the Association for the purpose of obtaining insurance, then the moneys that have been so paid over become the property of the Association, and that the Association ought then in its turn to be liable to income tax in respect of the excess that they have received. It appears to me that there is no inconsistency in saying that both judgments of Rowlatt J. are right. True, in the first case the sum is deducted because it represents the cost of obtaining the insurance by the assured, but it does not necessarily follow that the money received by the Association is as to a part of it the reaping of a reward or gain by the Association. *It must still be looked at from the point of view of mutual insurance. Regarded as such, the Association does not make a profit or gain which is of the nature or character which subjects it to income tax.*

Scrutton L.J., after referring to the fact that if a member withdrew he only got back part of his share of the reserve fund, the balance being retained by the Association, considered this did not affect the matter and that no part of the accumulations added to the reserve fund from year to year were subject to taxation.

The report of the proceedings in the House of Lords (1), shows that the same arguments now made on behalf of the Minister were made by the Attorney-General and there rejected. It was contended that since the company was carrying on a trade or business, within the meaning of the Income Tax Act, 1918, the surplus of the receipts over the expenditures was profit and that it was immaterial how that profit was applied, that the company owned the contributions of the members in response to calls and the reserve fund belonged to the company and was available to creditors and that no individual member had an interest in it. Viscount Cave considered that the decision of the House in the *New York Life* case (*supra*) completely covered the case. The accumulated reserve fund of the Coal Owners' Association exceeded £150,000. A passage from the Lord Chancellor's judgment reads (p. 832):—

> In this case, as in the *New York Life Insurance Co.'s* case, (2), there are no shareholders interested, and the whole of the yearly surplus remains to the credit of the members, and must either be applied to meeting their future claims or be returned to them on retirement. Sooner or later, in meal or in malt, the whole of the company's receipts must go back to the policy holders as a class, though not precisely in the proportions in which they have contributed to them; and the association does not in any true sense make a profit out of their contributions.

(1) [1927] A.C. 827. (2) 14 App. Cas. 369.

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While the first sentence of the above quotation would indicate that Lord Cave thought that the entire amount contributed to the reserve fund was refunded, the concluding sentence makes it clear, I think, that he had not failed to note that the contrary was the case and that less might be returned than had been paid in. The important point was that the whole of the fund must go back to the members as a class. By this, I assume he meant that this would occur on a winding-up or in the event of the discontinuance of business by the Association.

In *Ayrshire Employers Mutual Insurance Association, Ltd.* v. *Commissioners of Inland Revenue* (1), the Association had as its principal object the insuring of its members on the mutual principle against claims arising out of accidents to their workmen. By levies upon the members for premiums in excess of the amounts required, a reserve fund had been accumulated a proportion of the revenue from which was credited to each member. Members' accounts were cleared annually and when an account showed a surplus, part was returned to the member as a bonus the balance being retained by the Association. The articles provided that a retiring member, unless he was giving up his business, forfeited half of his contribution to the surplus assets. Where, however, he was giving up business, or if his membership was terminated by the Association, he was entitled to recover his whole contribution. The decision in *Jones* v. *South West Lancashire Coal Owners' Association* (2) was applied, the Court of Session deciding that the transactions between the Association and its members did not give rise to a profit subject to income tax. It is to be noted that in the course of the judgment of Lord Fleming (p. 427) he referred to a passage from a judgment of Lord Macmillan in *Municipal Mutual Insurance* v. *Hills* (3), where, after referring to the principle on which the surpluses arising in the conduct of a mutual insurance scheme are not taxable as profits, he said in part:—

> 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.

(1) [1944] S.C. 421. (2) [1927] 1 K.B. 33.
(3) (1932) 147 L.T.R. 62 at 68.

Lord Fleming did not appear to construe this as meaning that it was essential that the contributors to the reserve fund should be entitled to have refunded to them the full amount of their contributions, in view of the term of the by-laws referred to above. That portion of the argument directed to s. 31(1) of the Finance Act, 1933 does not touch the present matter.

The appeal to the House of Lords was dismissed (1). Lord Thankerton who, alone of the Law Lords, referred to what had been said by Lord Macmillan in the *Municipal Mutual Insurance* case and did not mention the provision in the by-laws whereby a member withdrawing received back only one-half of his contributions to the surplus, considered that the appeal failed.

Lord Macmillan, after referring to an argument advanced on behalf of the commissioners that a surplus arising from transactions of the company with non-members was taxable, said (p. 640):

> The hypothesis is that a surplus arising on the transactions of a mutual insurance company with non-members is taxable as profits or gains of the company. But unfortunately for the Inland Revenue the hypothesis is wrong. It is not membership or non-membership which determines immunity from or liability to tax; it is the nature of the transactions. If the transactions are of the nature of mutual insurance, the resultant surplus is not taxable whether the transactions are with members or with non-members.

In my opinion, the business carried on by the appellant company in the taxation year 1947 is properly described as that of mutual insurance. The purpose of the company, as declared by the letters patent, is that of insuring on the premium note plan, subject to the provisions of Part II of the Companies Act and of *The Insurance Act, 1937*. A premium note is defined by s-s. 48 of s. 2 of the latter statute to mean:—

> An instrument given as consideration for insurance whereby the maker undertakes to pay such sum or sums as are legally demanded by the insurer, the aggregate of such sums not to exceed an amount specified in the instrument and includes any undertaking to pay such sums regardless of the form thereof and whether or not accompanied by a deposit of money or security.

(1) [1946] 1 All. E.R. 637.

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The premium notes taken by the appellant company conform to the first part of this definition. It is of the essence of such a plan that each member insuring with the company will to a maximum figure (being the principal amount of the note) and, from time to time during its currency, to the extent of the balance which may become payable under it, share the risk of loss by fire or lightning by any of the members with all the members of the company. Such a plan falls within the definition of "Mutual Insurance" in s-s. 40 of s. 2 of the Act and, in addition, within the generally accepted meaning of the term.

I think it is true that the question does not differ from that which would arise had those persons who were members of the appellant company for the year 1947 entered into an agreement among themselves each to contribute his proportionate share of the loss by fire suffered by any of them to an agreed amount, the members' liability being limited to, say, the sum of $20, each member to contribute part of this sum in cash in order to pay expected losses and the expenses of carrying out the plan, assessments to be made upon the notes for further amounts when required by a committee of the members, any surplus resulting from the cash payments and such assessments to be placed at the end of the year in a reserve fund to the credit of the members, any member withdrawing from the plan during the year to forfeit any interest he might have in the amount so accumulated. Had this plan been followed it would be quite impossible, in my opinion, to sustain a contention that such a fund represented a profit or was taxable income if distributed among the members, except perhaps to the extent that they might individually participate or be entitled to participate in the portion of such surplus contributed by members who had withdrawn. That would be a truly mutual plan of insurance and I think the situation is not changed when the members, availing themselves of the provisions of the Companies Act and *The Insurance Act, 1937,* carry out such a plan through the medium of an incorporated company.

The plan provided by the terms of Part II of the Companies Act and the relevant sections of the Insurance Act enables persons wishing to associate with others in such

an enterprise to substitute the covenant of a separate legal entity for the individual covenant of the proposed members. It is clear that in enacting this legislation it was contemplated that the persons who would take advantage of its provisions would be unlikely to be skilled in insurance matters and perhaps in financial matters involving the undertaking of considerable financial obligations. Accordingly, after organization in the manner required by the Companies Act, the operations were made subject to the supervision of the Superintendent of Insurance and, *inter alia,* the forms to be used and the extent of the assessments to be made upon the premium notes made subject to his approval. While such a company could, no doubt, operate by assessing its members upon their premium notes from time to time as losses occurred, the Legislature apparently considered it prudent to require the establishment of a reserve fund to the amount provided in s. 249 of the Insurance Act, to be available to pay the liabilities of the company to the extent that the ordinary receipts were insufficient. Much importance has been attached in argument to the fact that by s-s. 3 of that section the reserve fund is declared to be the property of the insurer. Since it is the company that incurs the obligation to the members by issuing policies of insurance, of necessity the reserve fund must be its property, since the whole purpose of the requirement is that it may be resorted to in satisfaction of the company's liabilities. The argument loses its force when it is realized that the fund is accumulated as directed by the statute, not in pursuance of a profit making enterprise but in furtherance of a mutual insurance plan carried on by the company in the interests of its members and which may not be applied, except on the order of the Governor in Council, to any purpose other than the settlement of claims or other liabilities. Counsel for the respondent argues that the case at bar is distinguished from the cases relied upon by the appellant by reason of the further provisions of ss. 3. The argument is that any surplus ultimately remaining after payment of all claims will not necessarily be returned to the members. I think it clear, however, from the provisions of the Winding-up Act (R.S.N.B. 1927, c. 97) and of the Insurance Act (S. of N.B. 1937, c. 44), read together, that on a winding-up the

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surplus, if any remaining after payment of the liabilities, would be returned to the members of the company. In the *Jones* and the *Ayrshire Employers Mutual* cases, the fact that only part of the amounts contributed by the members to the reserve fund was in certain circumstances returned to them on their withdrawal was held not to affect the matter and it was decided that the amounts thus accumulated from year to year were neither profits nor gains of the Association. In my opinion, the principle applied in these two cases is applicable to the present case.

Counsel for the Minister referred to para. (*d*) of s-s. 1 of s. 6 of the *Income War Tax Act* which provides that in computing the amount of the profits or gains to be assessed a deduction shall not be allowed in respect of amounts transferred or credited to a reserve, except such an amount for bad debts as the Minister may allow and except as otherwise provided in the Act. This, however, clearly refers to amounts received which must properly be taken into account in determining whether a profit or loss has resulted from the company's operations and cannot, in my opinion, apply to amounts such as are in question here received by the company for the purpose defined by the Insurance Act.

With all the great respect that I hold for any opinion of Mr. Justice Hyndman, my consideration of the present matter leads me to a different conclusion. This appeal should be allowed with costs here and in the Exchequer Court.

TASCHEREAU J.:—For the reasons given by my brother Locke I would allow this appeal with costs here and in the Exchequer Court.

Appeal allowed with costs.

Solicitors for the appellant: *Francis, Woods, Gauley & Blair.*

Solicitor for the respondent: *F. J. Cross.*