2373.

LIFE INSURANCE POLICY—WHEN NOT TAXABLE AS PROPERTY OF INSURED.

A life insurance policy on which a loan has been made to the policy holder is not a "credit" belonging to the policy holder which he is obliged to list for taxation subject to deduction for debt.

A policy of life insurance while executory and in the hands of the policy holder is a kind of "investment" for the taxation of which no provision has been made by the law of the state.

COLUMBUS, OHIO, August 26, 1921.

Tax Commission of Ohio, Columbus, Ohio.

GENTLEMEN:—You have requested the advice of this department on a question submitted to you by Hon. H. Sage Valentine, auditor of Franklin county, which is as follows:

> "Can a taxpayer who holds a policy of life insurance having a loan value but who does not list said policy as a credit to the extent of its loan value set off against other credits listed by him the amount of a loan secured by him upon said policy without listing said policy as a credit to the extent of its loan value?"

The question reduces itself to the simple inquiry as to whether or not an insurance policy, having a cash surrender value and a loan value, is taxable as property of the insured.

The supreme court of Ohio has dealt with this question in a dictum found in Chisholm vs. Shields, Treas., 67 O. S., 374, opinion of Burket, C. J., page 378, which may be quoted as follows:

> "Property not * * * specified in any section (of the statute) is not taxed; as for instance, investments in life insurance policies are not taxed, for the reason that no statute authorizes their taxation, although thousands, if not millions of dollars are invested in them, many being fully paid up, and others having a surrender value. Such policies are clearly property, and very valuable property at that, but not taxed, because no statute specifically requires their taxation. The same is true of many other valuable investments. So that the word 'otherwise' in section 2731 (R. S.) includes only such property or investments as are specifically mentioned and required to be taxed in the subsequent sections, and property or investments not so mentioned can not be taxed."

The learned chief justice was apparently discussing the word "otherwise" as used in the constitution and statutes following the enumeration of the classes of "investments" which are subject to taxation. In so doing he was assuming, it seems, that an insurance policy in the hands of the insured must be regarded as an "investment". It did not apparently occur to him that it could be looked upon as a "credit".

The auditor's letter requires that we consider the question of whether such a policy from that standpoint should be considered as a "credit" as well as to re-examine the question disposed of in dictum by the supreme court.

A "credit" is defined for the purposes of taxation as follows:

"Sec. 5327 G. C. The term 'credit' as so used, means the excess of the sum of all legal claims and demands, whether for money or other valuable thing, or for labor or service due or to become due *to the person liable to pay taxes thereon,* including deposits in banks * * * other than such as are held to be money * * * when added together, * * * over and above the sum of legal bona fide debts owing by such person."

A life insurance policy of the ordinary type does not represent a claim or demand for money due or to become due to the insured. It evidences a contract whereby, primarily at least, the insurer agrees to pay money in the event of the death of the insured. All policies, however, contain stipulations fixing the values thereof from year to year in case of a surrender of the contract and the terms on which loans will be made on the policies.

The cash surrender value of a policy of insurance is in effect the amount which according to the terms of the contract the company agrees to pay to the insured if the insured exercises the option of surrendering the policy and requires the payment of that value. It cannot be regarded as a credit because the right to collect the amount represented thereby is contingent upon the making of an election which has not been made. Of course, after the election has been made and before the cash surrender value has been collected, the amount represents a taxable credit.

The process of making loans on policies is defined usually in the policies themselves in language something like the following, which is quoted from a specimen policy of one of the Ohio companies:

"After three full years' premiums have been paid and if no premium payment is in default, the company will advance, on proper assignment of this policy and on the sole security thereof, a sum not exceeding the amount specified in column 3 of the 'Table of Guarantees' * * * and the reserve on any additions to this policy, deducting therefrom all indebtedness to the company against this policy and any unpaid balance of premium for the current policy year. * * * Failure to repay any such loan or interest shall not avoid this policy unless the total indebtedness to the company on this policy shall equal or exceed such loan value at the time of such failure, * * *"

In other words, in order to secure a loan on an insurance policy of which the above is typical, the insured is required to make or procure to be made an assignment of the policy to the company as security for the loan. The rights of the parties under such assignment are simply that if the death occurs before the loan is paid, the amount of the loan with interest may be deducted from the face of the policy otherwise payable in accordance with its terms; and if a default in payment occurs during the lifetime of the insured, then the amount of the loan with interest will be withheld from the amount that would otherwise be payable as the surrender value of the policy.

It is clear upon analysis of such a contract that when a loan has been made and the policy has been assigned to the company as security for it, there is no taxable credit running from the company to the insured or to any one else as a result of the loan. The legal situation is somewhat similar to the case in which money is borrowed on the security of bonds or notes of third persons which are assigned or endorsed to the lender. The relation of debtor and creditor as between the lender and borrower does not arise by reason of such assignment, but the relation of pledgee and pledgor is that

which subsists. So here the company becomes the assignee in law and the pledgee in fact and in equity for the purpose of securing the repayment of the loan. It does not become a debtor to the policy holder. In fact, the situation of the parties with respect to the relation of debtor and creditor is precisely reversed from that supposed by the auditor.

It is concluded therefore that the answer to the precise question submitted by the auditor is in the affirmative and that a taxpayer who has borrowed money from an insurance company on the security of his policy of life insurance in that company may include his indebtedness to the company with his other indebtedness which he is entitled to deduct from his credits, without being required to include anything on account of the transaction in his list of taxable credits from which the deduction is to be made.

It is believed that the supreme court was right in dealing with the contract rights of an insurance policy holder as investments. It is obvious that not all contracts under which money may become payable to the obligee are "credits" for taxation purposes because bonds and annuities are contracts calling for the payment of money at stipulated times and these are considered not as credits but as investments for the purpose of taxation. The line between investments of this character and claims and demands which fall within the category of credits may be somewhat difficult to draw. For example, the ordinary promissory note of an individual is a credit for the purpose of taxation, while a bond issued by a municipal corporation or private corporation, which is negotiable and has many if not all the attributes of a promissory note, is to be classed as an investment. Looking at the substantial nature of a life insurance contract however, its character as an investment appears rather clear. It is a contract entered into without any intention of creating the relation of debtor and creditor between the parties as in the case of an ordinary loan. To be sure there will come a time when on the happening of certain events or the exercise of certain options money will be due and payable and that relation will arise; but during the time when the policy remains executory in all of its aspects the relation of debtor and creditor does not exist and the contract is one entered into with a view to future accumulation usually on behalf of some person other than the obligee of the original contract and so must be considered to be an investment and not a credit. As previously stated, the exercise of the options and the doing of the acts that form the basis for securing a loan on such a policy do not change the essential character of the original contract.

It is concluded therefore that if an insurance policy is taxable at all to the insured, it must be taxable as an investment. At this point the dictum of the supreme court applies and unless we are to reject it, becomes the governing law of the state. In the opinion of this department the dictum should be followed. There is much sound sense in it. As an investment, a life insurance policy has so many peculiarities that it could not have been in contemplation of the legislature to tax it under general rules. Other investments, for example, are subject to sale, but life insurance policies are not entered into with any view on the part of the insured to dealing in them or selling them, even to the extent that they may be assignable. So it would seem that if the general assembly had intended to tax life insurance policies it would have done so by using appropriate words. To be sure the general assembly is not at liberty to exempt property from taxation as a matter of choice, but in Article XII, section 2, of the constitution, is directed to pass laws taxing all property. Conceivably, however, it may omit to cover every species of valuable property rights of an intangible character, and the case cited, together with others that might be cited, is authority for the proposi-

tion that when such an omission is made, though the constitution is violated in an academic sense, the result can not be reached that the omitted property is therefore subject to taxation.

Accordingly it is the opinion of this department that the making of a loan on a policy of life insurance to the policy holder does not give rise to any obligation on the part of the policy holder to list any interest he may have in the policy for taxation.

Respectfully,
JOHN G. PRICE,
Attorney-General.

2374.

INHERITANCE TAX LAW—CONSIDERATION OF A CERTAIN TRUST AGREEMENT ENTERED INTO IN 1916 WHEREBY GRANTOR CONVEYED TO TRUST COMPANY CERTAIN PROPERTY WITH POWER TO HOLD AND MANAGE SAME, PAY INCOME TO GRANTOR FOR LIFE AND AT DEATH OF GRANTOR TO DIVIDE SAME IN CERTAIN MANNER.

On the 9th day of February, 1916, *S entered into an agreement with the C Trust Company whereby he conveyed to such company certain property with power to hold and manage the same, pay the income therefrom to the grantor for his life and at the death of such grantor to divide the same in certain manner among certain specified persons. The trust agreement contained the following language:*

'I reserve the right at any time during my life or so long as I am competent to act in the matter, to revoke the settlement hereby evidenced, either in whole or in part, as well as the right to modify in any respect the terms of this settlement, any such revocation or modification to be evidenced by written instrument to be signed by me and delivered to the trustee.'

S died subsequent to June 5, 1919.

HELD:

1. *The trust agreement was effectual to vest ultimate beneficial estates in the persons to whom distribution was to be made.*

2. *Query as to effect of section* 8617 *G. C. If this section is to be construed as making the trust voidable only, the taxing authorities are not in a position to avoid it.*

3. *That the successions arising under the instrument are taxable in the abstract; whether they are to be taxed under the collateral inheritance tax law in force at the time of the execution of the trust agreement or under the inheritance tax law of* 1919, *in force at the time of the death of the donor, is a doubtful question which should be submitted to the courts for determination, the taxing authorities taking the view that the later law governs.*

COLUMBUS, OHIO, August 26, 1921.

Tax Commission of Ohio, Columbus, Ohio.

GENTLEMEN:—Some time ago the commission requested the opinion of this department upon the following questions:

"On the 9th day of February, 1916, S entered into an agreement with the C Trust Company whereby he conveyed to such company