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INSURANCE COMPANY—SECTION 5414-9 G. C.—LEVIES ANNUAL FRANCHISE TAX, MEASURED BY CAPITAL AND SURPLUS OF DOMESTIC INSURANCE COMPANY—PRIVILEGE OF BEING INSURANCE COMPANY—FEDERAL SECURITIES OWNED BY COMPANY—SHOULD BE INCLUDED IN DETERMINATION OF AMOUNT OF CAPITAL AND SURPLUS.

SYLLABUS:

Under the provisions of Section 5414-9, General Code, which levies an annual franchise tax, measured by the capital and surplus of a domestic insurance company, on the privilege of being an insurance company, federal securities owned by such company should be included in the determination of the amount of such capital and surplus.

Columbus, Ohio, July 14, 1952

Hon. Walter A. Robinson, Superintendent of Insurance
Columbus, Ohio

Dear Sir:

I have before me your request for my opinion, reading as follows:

"Section 5414-9 and subsequent sections of the General Code of Ohio impose an annual franchise tax on the privilege of being a domestic insurance company, measured either by capital and surplus or by gross amount of Ohio premiums, with certain adjustments in each case, whichever basis of measurement shall be the smaller.

"In 1932 the then Attorney General advised one of my predecessors that the Ohio property tax on capital and surplus of a domestic insurance company was invalid under the Constitution and laws of the United States in so far as it applied to certain federal securities. In the following year, the Ohio General Assembly repealed the property tax and enacted the present franchise tax with its alternative tax basis. Under said Section 5414-9 and following it is my duty to certify to the Auditor of State the correct amount of capital and surplus or of gross Ohio premiums, after statutory adjustments, whichever basis shall be the smaller.

"I am in doubt as to whether, in view of the decision of the Supreme Court of Ohio in the case of Wrenn Paper Company vs. Glander, 156 Ohio St., 583, 158 Ohio St., 15, I should

or should not include federal securities in any certification of capital and surplus made by me.

"Your opinion and advice in the premises is respectfully requested."

The Wrenn case was before the Supreme Court on two occasions, on the original hearing and on rehearing. The original hearing is reported in 156 Ohio St., 583, and the rehearing in 158 Ohio St., 15. Your question calls for a somewhat detailed consideration of the issues presented in such case and a determination of how such issues were ultimately determined by such court.

The taxpayers in the Wrenn case were not domestic insurance companies and, thus, Section 5414-9, et seq., General Code, was not in issue or in any way involved in that case. Instead, the statutes there under consideration were Sections 5485 to 5524, inclusive, General Code, which provide generally for a franchise tax on corporations organized for profit under the laws of this state. By the specific language of Section 5503, General Code, corporations required to file annual statements with the Superintendent of Insurance are excluded from the operation of this general corporation franchise tax. Thus, it clearly appears that the Supreme Court, in the Wrenn case, did not have before it the specific question you have presented for my consideration.

Before further discussing the Wrenn case, it might be well to note the points of similarity and dissimilarity between the general corporation franchise tax and the domestic insurance company franchise tax. Both, of course, are *franchise* taxes, the tax on domestic insurance being levied "on the privilege of being an insurance company" (Section 5414-9, General Code,) and the general corporation franchise tax being levied as to domestic corporations "for the privilege of exercising its franchise" (Section 5495, General Code.) Both provide basicly for measuring the tax by the capital and surplus (Sections 5414-9 and 5498, General Code.) The domestic insurance company franchise tax, however, provides an alternative measure, i. e., eight and one-third times the gross premiums on risks in Ohio, less return premiums and considerations for re-insurance. Whichever of these two measurements is the smaller is applied in determining the tax.

The taxpayers in the Wrenn case asserted that federal securities were not properly includable in the tax base formula under the provisions

of Section 5495, et seq. for two separate reasons. The first, hereafter referred to as the "federal issue," was the claim that the inclusion of the value of such federal securities in the tax-base formula, i. e., the inclusion of such value in the measure of the tax as a part of the capital and surplus, would be violative of Article I, Section VIII of the United States Constitution, which provides that Congress shall have power to "borrow money on the credit of the United States" in that such inclusion, in legal effect, would impose a tax on such securities in violation of Section 742, Title 31, U. S. Code, which provides:

> "Except as otherwise provided by law, all stocks, bonds, treasury notes, and other obligations of the United States shall be exempt from taxation by or under state or municipal or local authority."

The second, hereafter referred to as the "state issue," was the claim that in any event the provisions of Section 5498, General Code, when read in connection with Sections 5328-1 and 5323, General Code, excluded federal securities from the determination of the franchise tax.

In the original hearing, reported in 156 Ohio St., 583, the court upheld the taxpayers as to both contentions. The "federal issue," as then determined, was contained in paragraphs 1 and 2 of the syllabus, as follows:

> "1. United States securities, and interest accrued thereon, owned by a domestic corporation of this state are within the operation of the provision of Section 742, Title 31, U. S. Code, that 'all stocks, bonds, treasury notes and other obligations of the United States shall be exempt from taxation by or under state or municipal or local authority.'
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> "2. Where the Tax Commissioner of Ohio, in determining the franchise tax on an Ohio domestic corporation for profit, under the provisions of Section 5495 et seq., General Code, includes in the tax-base formula the value of federal securities owned by the corporation, and thereby the amount of such tax is increased, such inclusion in legal effect imposes an illegal tax on such securities."

These two paragraphs of the syllabus were concurred in by Judge Hart, who wrote the opinion, and Judges Zimmerman, Stewart, Middleton, Matthias and Taft. Chief Justice Weygandt indicated neither approval nor dissent.

As to the "state issue," the majority of the court decided that Sections 5498, 5328-1 and 5323, supra, "must be read *in pari materia*, and, when so read, such statutes exclude federal securities from the determination of the franchise tax." This is the holding of paragraph 3 of the syllabus.

Had the Wrenn case ended at this point, it could have been argued with great force that such decision would also compel the elimination of federal securities from the first alternative measure of the domestic insurance company franchise tax, provided by Section 5414-9, i. e., would compel the elimination of federal securities from the determination of the capital and surplus. There is weight to the argument that even in such event the fact that alternative tax measures are provided by Section 5414-9, thus clearly demonstrating the fact that the tax is a franchise tax on the privilege of being an insurance company and not a tax on the securities themselves, would make such a decision inapplicable to Section 5414-9. However this may be, it is not necessary to express any opinion as to this possible point of distinction for the reason that on rehearing a majority of the court receded from the holding of paragraphs 1 and 2 of the original syllabus. Upon rehearing four judges adhered without opinion to the judgment announced in the first decision. The court merely announced:

> "The court adheres to the judgment heretofore rendered (*Wrenn Paper Co.* v. *Glander, Tax Commr.*, 156 Ohio St., 583.)"

Judges Stewart, Matthias and Hart concurred in this adherence. Respecting the views of the other judges, it was announced that:

> "Middleton, J., adheres to paragraph three of the syllabus and to the judgment.
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> "Weygandt, C. J., Zimmerman and Taft, JJ., dissent."

It is significant that, in announcing the action of the court on rehearing, none of the judges stated his adherence to paragraphs 1 and 2 of the original syllabus. The most which may be inferred is that Judges Stewart, Matthias and Hart, a minority of the court, may have adhered to paragraphs 1 and 2, as well as to paragraph 3. Judge Middleton announced his adherence only to paragraph 3 and to the judgment. Chief Justice Weygandt, and Judges Zimmerman and Taft, dissented.

It is apparent, therefore, that at least a majority of the court has now rejected the former holding of the court, as contained in paragraphs

1 and 2 of the original syllabus and, in effect, have now held that there is no constitutional or federal bar to the inclusion of federal securities in the measure of a franchise tax.

While the majority of the court did adhere to the previous judgment, I believe that it is quite apparent that such judgment is now based solely on the "state issue." In other words, the court now holds that the General Assembly *may* constitutionally include the value of federal securities in the measure of a franchise tax without violating the provisions of Article I, Section VIII of the United States Constitution or the provisions of Section 742, Title 31, U. S. Code, but that the General Assembly, by the enactment of Sections 5498, 5328-1 and 5323, General Code, read in pari materia, did not *choose* to include federal securities in the measure of such franchise tax.

Has the General Assembly chosen to include federal securities in the measure of the domestic insurance companies franchise tax? I think it quite obvious that it has. The majority holding in the Wrenn case on the "state issue" was based entirely on the fact that Section 5498, supra, provided that "In determining the amount or value of intangible property, including capital investments, owned or used in this state by either a domestic or foreign corporation the commission shall be guided by the provisions of Section 5328-1 and 5328-2 of the General Code;" the fact that Section 5328-1, in turn, a part of the intangible property tax laws, provided that intangible property, including investments, shall be subject to taxation "excepting as provided in this section or as otherwise provided or exempted in this title;" and the fact that Section 5323, a part of "this title," in defining the term "investment," excluded therefrom federal securities. In other words, the majority of the court held that this sequence of statutes indicated a legislative intent not to include within the capital and surplus, as provided for in Section 5498, General Code, the value of any securities not defined as "investments" by Section 5323.

While we must now accept this holding as being the correct interpretation of Section 5498, when read in connection with Sections 5328-1 and 5323, such holding has absolutely no application to Section 5414-9 for the reason that this section contains no reference to Sections 5328-1 or 5323.

It is clear, therefore, that the Wrenn case, as ultimately determined on rehearing, supports the proposition that the value of federal securities

may constitutionally be included in the measure of a franchise tax, based on capital and surplus, and that the holding in favor of the taxpayers therein was based solely on an interpretation of certain statutes in no way related to the statutes levying a franchise tax on the privilege of being an insurance company.

Although I believe that the foregoing answers your question, I think it advisable that I discuss briefly the decisions of the United States Supreme Court dealing with this general question, and particularly the case of New Jersey Realty Title Insurance Co. v. Division of Tax Appeals, 338 U. S. 665. I believe such discussion advisable in view of the fact that the original holding in the Wrenn case on the "federal issue" was based entirely upon an erroneous construction as to the scope of the holding of the United States Supreme Court in the New Jersey case, and since on rehearing, while at least the majority of the court necessarily rejected such erroneous construction, no opinion was written at that time on such "federal issue." It is evident from the original opinion (pages 587 and 588) that the court *originally* construed the New Jersey case as holding that federal securities could not be included in computing capital and surplus, regardless of whether the tax in question was or was not a *franchise* tax. A careful analysis of the New Jersey case clearly reveals that the tax there under consideration was *not* a *franchise* tax, but, instead, a *property* tax. The New Jersey legislature had so denominated it, the New Jersey taxing authorities and the New Jersey courts had so considered it and the majority of the Supreme Court, while stating that they were not bound by any of such declarations or assumptions, also considered the New Jersey tax to be a *property* tax.

The sole point in dispute between the majority opinion of Mr. Justice Clark and the dissent of Mr. Justice Black was whether the New Jersey tax should be treated as something akin to a franchise tax. Since the New Jersey tax provided that "no franchise tax shall be imposed upon any insurance company included in this section," Mr. Justice Black was of the opinion that "this tax at least replaced a franchise tax" and that it, therefore, fell within the scope of prior decisions of that court sustaining the power of states to levy a tax on a legitimate subject such as a franchise, measured by *net assets* or net income, including tax-exempt federal instrumentalities. Tradesmens Nat. Bank v. Oklahoma Tax Com., 309 U. S. 560; Educational Films Corp. v. Ward, 282 U. S. 379; Society

for Savings v. Coite, 6 Wall. 594; Provident Institution v. Massachusetts, 6 Wall. 611, Hamilton Mfg. Co. v. Massachusetts, 6 Wall. 632; Home Ins. Co. v. New York, 134 U. S. 594; Pacific Co. v. Johnson, 285 U. S. 480.

The majority opinion of Mr. Justice Clark did not question the prior holdings of that court which, as late as the case of Tradesmens Nat. Bank v. Oklahoma, supra, held that "The power of a state to levy a tax on a legitimate subject, such as a franchise, measured by net assets or net income, including tax-exempt federal instrumentalities or their income is likewise well settled." Instead, the majority opinion merely held that the particular tax in question was not a franchise tax. It, in effect, merely re-affirmed its prior holding in the case of New York, ex rel. Bank of Commonwealth v. Tax & A. Comrs., 2 Wall 200, to the effect that a property tax could not be levied on capital and surplus and include therein federal securities. This explains the statement of Mr. Justice Clark that "In considering the similar tax on capital and earned surplus under review in the Bank tax case, supra, this court declared that the levy was imposed on the property of institutions contra-distinguished from a tax upon their privileges or franchises." The fact that the majority did not consider the New Jersey tax as a franchise tax was made clear by the statement from the majority opinion that "we likewise do not think that the assessment can be sustained as one levied on a corporate franchise."

As contra-distinguished from the New Jersey case, the tax here in question is levied on a corporate franchise, i.e., "on the privilege of being an insurance company." At the time of the 1932 Attorney General's opinion, referred to in your letter (Opinion No. 4250, Opinions of the Attorney General for 1932, page 558,) the tax on domestic companies under consideration was a property tax. Section 5328-1, which provided generally for the taxation of intangible personal property, at that time specifically provided for the levy of such an intangible personal property tax on the "capital and surplus of domestic insurance companies." Section 5328-1 was amended by the succeeding session of the General Assembly to eliminate such property tax on domestic insurance companies, 114 O. L. 554. At the same time, Section 5414-9 was amended to its present form, providing for an "annual franchise tax on the privilege of being an insurance company."

In summation, it clearly appears that the Wrenn case, as ultimately determined on rehearing, and all of the decisions of the United States Supreme Court heretofore referred to, fully support the constitutional power of the State of Ohio to levy a *franchise tax,* measured by capital and surplus, and include within the determination of such capital and surplus federal securities. It also clearly appears that the holding of the Wrenn case, that federal securities should be excluded in the determination of the franchise tax under Section 5498, General Code, as read in pari materia with Sections 5328-1 and 5323, General Code, has no application to the domestic insurance company franchise tax levied by Section 5414-9, General Code.

In specific answer to your question, therefore, it is my opinion that under the provisions of Section 5414-9, General Code, which levies an annual franchise tax, measured by the capital and surplus of a domestic insurance company, on the privilege of being an insurance company, federal securities owned by such company should be included in the determination of the amount of such capital and surplus.

Respectfully,

C. WILLIAM O'NEILL
Attorney General