NCSL TASK FORCE ON STATE AND LOCAL TAXATION

STATE TAXATION OF THE INSURANCE INDUSTRY
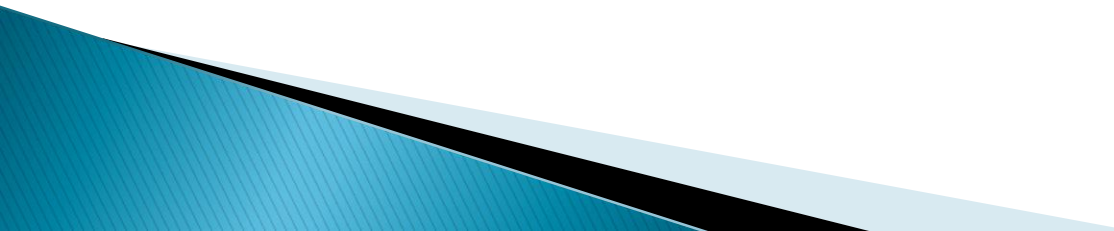
Jim Hall, Regional Vice President
American Council of Life Insurers

Bob Montellione, Vice President State Tax Policy
Prudential Financial, Inc.

Jim Williams, Vice President and Associate General Counsel
Mass Mutual

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PRESENTATION OVERVIEW

- HISTORY OF STATE INSURANCE TAXATION

- OVERVIEW OF PREMIUM TAXES

- OVERVIEW OF RETALIATORY TAXES

HISTORY OF STATE INSURANCE TAXATION
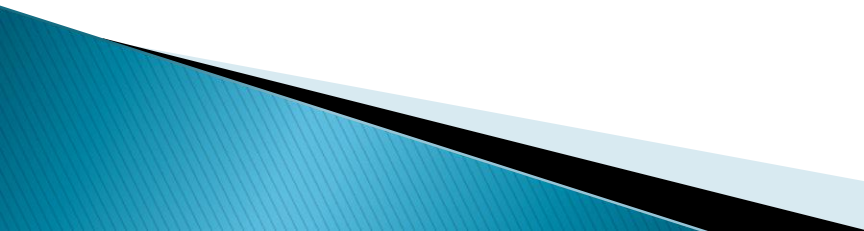
1) **Insurance Tax History**

- Early stages of state taxation of insurance companies
- Discriminatory taxes
- Retaliatory taxes

- Questions:
  - Is insurance "commerce?"
  - Are corporations "citizens?"

HISTORY OF STATE INSURANCE TAXATION

1) <u>Paul v. Virginia</u> (1869)

- Issuing a policy of insurance "is not a transaction of commerce. " Thus, the Virginia bond requirement for foreign insurers does not violate the Commerce Clause.
- A corporation is not a "citizen" within the meaning of the Privileges and Immunities Clause, so the Virginia foreign insurer bond requirement does not violate the Clause.

HISTORY OF STATE INSURANCE TAXATION

1) <u>United States v. Southeastern Underwriters Association</u> (1944)

- Overturned <u>Paul v. Virginia</u>
- An insurance company which conducts a substantial part of its business transactions across state lines is engaged in "commerce among the several States," and as such, under the Commerce Clause insurance can be regulated by the federal government .
- The Sherman anti-trust act applies to the business of insurance.

HISTORY OF STATE INSURANCE TAXATION
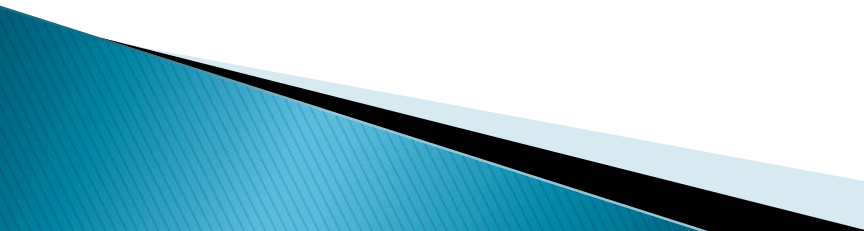
1) ## McCarran Ferguson Act (1945)

- No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended [15 U.S.C. 41 et seq.], shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.

- Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

HISTORY OF STATE INSURANCE TAXATION

1) <u>Western and Southern v. State Board of Equalization</u> (1981)

- California's retaliatory tax does not discriminate against foreign insurers in violation of the Commerce Clause.
- Retaliatory taxes are constitutional so long as their primary purpose is to discourage other states from imposing higher taxes on a state's domestic insurers.

HISTORY OF STATE INSURANCE TAXATION

1) <u>Metropolitan v. Ward</u> (1985)

- Alabama disparate tax rates challenged on the basis of Equal Protection Clause.

- Holding: Facially discriminatory tax rates (charging foreign companies a higher rate than domestic companies) violates the Equal Protection Clause unless a "legitimate state purpose" can be shown.

OVERVIEW OF PREMIUM TAXES

1) All states (except Oregon) and DC subject insurance companies to premium taxes

   - Municipal/local premium taxes are also imposed by 5 states

2) Premium taxes are imposed "in lieu" of income taxes in most states

   - About 10 states impose both premium taxes and income taxes on insurance companies
   - Those 10 states provide either a premium tax credit for income taxes or a "cap" of some sort based on instate premiums

3) "In lieu" provisions do not exempt an insurance company from the imposition of other state taxes, such as property taxes and sales/use taxes
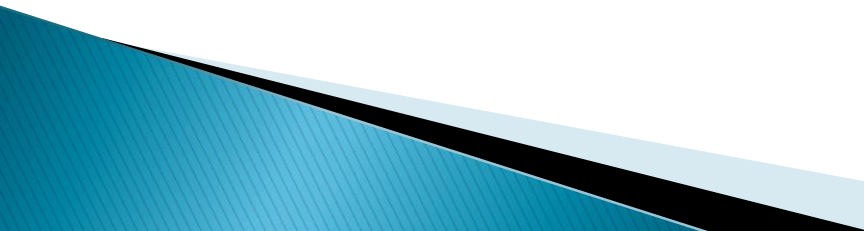
OVERVIEW OF PREMIUM TAXES

1) Premium Tax Base

- Imposed on gross premiums derived from instate risks
  - Defined as gross premiums written, collected or received

- Instate Risks
  - Insured's residence for individual, group and health insurance
  - Location of property for property/casualty insurance

- Catch-all Provisions
  - These provisions exist in a number of states
  - Essentially similar to a "throwback sale"
  - If insurance company is not taxable where risk is located, premiums allocated to state of policy administration

OVERVIEW OF PREMIUM TAXES

1) Deductions from the premium tax base are limited
   - Very much akin to a gross receipts tax

2) Examples of deductions
   - Policy holder dividends
   - Returned premiums
   - Qualified premiums (e.g., 401 plans, IRAs)
   - Premiums from governmental agencies/institutions

3) Policy Exchanges
   - Considered new premiums
     - Occurs when insurance company A takes over from insurance company B
     - Funds transferred to insurance company A will again be taxable

OVERVIEW OF PREMIUM TAXES

1) ## Credits against premium taxes
   - Guaranty association assessments
     - ➢ Imposed when an insurance company becomes insolvent
     - ➢ Other insurers assessed to cover estimated claims
     - ➢ Amounts paid generally allowed as credits over 5 years
   - Income taxes
   - Jobs
   - Low income housing
   - Enterprise zones

2) ## Overlooked industry

3) ## Retaliatory tax implications
   - Credit statutes must ensure that the benefit of the credit is not taken back through the imposition of retaliatory taxes

OVERVIEW OF PREMIUM TAXES

1) ## Premium tax rates

- Average premium tax rate is slightly below 2%
  - ➢ Rates range from .5% to 4.35%
  - ➢ Per recent E&Y study, converts to a net income tax rate of nearly 20%

- Rates can differ by product line within the state
  - ➢ Life insurance
  - ➢ Health insurance
  - ➢ Property/Casualty
  - ➢ Fire

OVERVIEW OF RETALIATORY TAXES

1) 49 States and DC have a retaliatory tax

- Tax is unique to insurance industry
- Permits Discrimination
- Constitutionality of CA retaliatory tax upheld by U.S. Supreme Court - Western and Southern v. Board of Equalization (1981)

OVERVIEW OF RETALIATORY TAXES

1) A non-domestic insurer must pay the greater of:

- The actual tax, fee and assessment burden imposed in the state in which the insurance company writes premium (i.e. the state where the company is filing a return), or

- The tax, fee and assessment burden that would be imposed by the insurance company's state of domicile using the amount of the actual business being written in the filing state
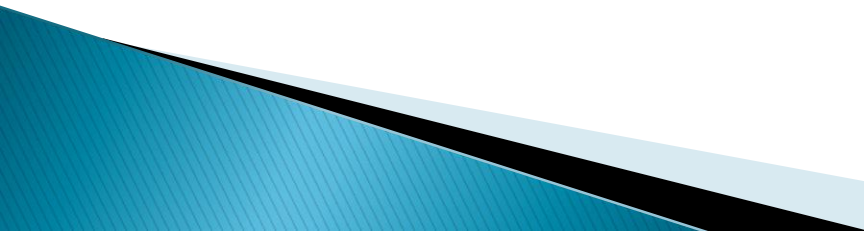
OVERVIEW OF RETALIATORY TAXES

1) Typical Retaliatory Tax Statute

- IOWA - §505.14

  ➢ When by the laws of any other state a premium or income or other taxes, or fees, fines, penalties, licenses, deposit requirements or other obligations, prohibitions or restrictions are imposed upon Iowa insurance companies actually doing business in the other state, or upon the agents of the Iowa companies, which in the aggregate are in excess of the aggregate of the taxes, fees, fines, penalties, licenses, deposit requirements or other obligations, prohibitions or restrictions directly imposed upon insurance companies of the other state under the statutes of this state, the same obligations, prohibitions or restrictions of whatever kind are in the same manner and for the same purpose imposed upon insurance companies of the other state doing business in Iowa.

OVERVIEW OF RETALIATORY TAXES

1) Elements of Computation

- Premium tax rates

- Credits

- Exemptions and deductions

- Insurance company assessments

- Local premium taxes

- Other insurance industry taxes, fees or burdens

OVERVIEW OF RETALIATORY TAXES

1) Basic Retaliatory Tax Example–CT Domestic Writing In IA

	CT (1.75%)	IA (1%)
$1M Premium		
Premium Tax	$17,500	$10,000
Assessments	$1,000	$3,000
Fees		
➢ Department of Insurance	$1,250	$1,000
Total	$19,750	$14,000
➢ Retaliatory Tax		$5,750
Total IA Tax Liability		$19,750

OVERVIEW OF RETALIATORY TAXES

1) Basic Retaliatory Tax Example–CT Domestic Writing In NJ

$1M Premium	CT (1.75%)	NJ (2.1%)
Premium Tax	$17,500	$21,000
Assessments	$1,000	$3,000
Fees		
➢ Department of Insurance	$1,250	$1,000
Total	$ 19,750	$25,000
➢ Retaliatory Tax		$0
Total IA Tax Liability		$25,000

OVERVIEW OF RETALIATORY TAXES

1) **Basic Retaliatory Tax Example**–Unintended Consequence CT Domestic Writing In IA

$1M Premium	CT (1.75%)	IA (1%)
Premium Tax	$17,500	$10,000
Assessments	$1,000	$3,000
Fees		
➤ Department of Insurance	$1,250	$1,000
➤ Gross Tax Due	$19,750	$14,000
➤ Less Tax Credit		$1,000
Total	$19,750	$13,000
➤ Retaliatory Tax		$6,750
Total IA Tax Liability		$19,750

QUESTIONS?