DEPARTMENT OF TAXATION
2011 Fiscal Impact Statement

1. Patron Walter A. Stosch

2. Bill Number SB 1124

House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

Second House:
_____ **In Committee**
_____ **Substitute**
_____ **Enrolled**

3. Committee Senate Commerce and Labor

4. Title Memorandum of understanding between Department of Taxation and SCC

5. Summary/Purpose:

TAX understands that the Patron intends to offer a substitute for this bill. This fiscal impact statement is drafted based on the substitute.

This bill would transfer the administration of the insurance premiums tax from the SCC to TAX. This would include the processing of tax returns, the handling of payments and billing, customer service functions, collections, and auditing duties. TAX would also be responsible for administering the retaliatory costs assessment on certain foreign insurance companies, as well as the retaliatory costs tax credit for domestic insurance companies.

The SCC would continue to be responsible for the licensing of insurance companies and the administration of the maintenance fund.

This bill would also make certain changes to the taxation of surplus lines brokers to ensure that their tax is based on direct gross premiums from Virginia insureds as required by a recently enacted federal law.

This bill would also allow TAX and the SCC to exchange information.

This bill would be effective for taxable years beginning on and after January 1, 2013, except that certain provisions related to surplus lines brokers would be effective July 1, 2011.

This is an executive bill.

6. Budget amendment necessary: No.

7. Fiscal Impact (See Line 8.)

8. Fiscal implications:

Administrative Impact

This bill would result in an initial cost to TAX of $554,883 in FY 2013. This cost would include implementation and staffing costs. Additionally, TAX would incur ongoing annual costs of $210,632 beginning in FY 2014.

The SCC would have administrative cost savings as a result of this bill. The amount of these savings is unknown.

Any cost savings to the SCC, as well as any costs incurred by TAX, would be borne by the SCC Bureau of Insurance Maintenance Fund. The Maintenance Fund is a special fund out of which the SCC pays any expenses necessary for the regulation, supervision, and examination of insurance companies licensed by the SCC. Insurance companies and surplus lines brokers that are licensed in Virginia are required to pay annual regulatory assessments which are then placed in the Maintenance Fund.

Revenue Impact

This bill would not have a revenue impact. It would only shift the collection point of the insurance premiums tax from the SCC to TAX.

9. Specific agency or political subdivisions affected:

Department of Taxation
State Corporation Commission

10. Technical amendment necessary: No.

11. Other comments:

Insurance Premiums Tax

The State Corporation Commission ("SCC"), Bureau of Insurance collects and administers the license tax on premiums for insurance sold in Virginia. This tax is based on a specified percentage of the direct gross premium income earned from the applicable insurance type and is imposed in lieu of the corporate income tax.

The annual return for this tax is due on March 1. In addition, the companies subject to this tax must make quarterly estimated payments on April 15, June 15, September 15, and December 15. Roughly 1,500 licensed companies file approximately 7,000 returns annually. Furthermore, the SCC receives approximately 1,400 filings from insurance brokers annually.

Assessments for Retaliatory Costs

In a process unique to the insurance industry, some states impose an assessment for "retaliatory costs" on insurance companies headquartered in another state when the other state imposes taxes and regulatory costs that are higher than their tax rates. The retaliatory assessment is in addition to the regular taxes, fees or regulatory costs paid by all insurance companies. “Regulatory costs” include deposits of securities; the payment of taxes, fines, penalties, or fees; and restitutions, obligations, or conditions necessary for doing business.

When Virginia companies are subject to regulatory costs in another state that exceed Virginia’s regulatory costs for insurance companies, Virginia assesses a retaliatory cost on foreign companies domiciled in that state. The amount of retaliatory costs assessed is equal to the regulatory costs imposed by the other state on Virginia companies in excess of the regulatory costs that Virginia imposes on insurance companies. Any foreign company subject to the assessment of retaliatory costs must file a report by March 1 of each year that compares the regulatory costs imposed on insurance companies by Virginia with the costs imposed on Virginia companies by the foreign company’s state of domicile. Any payment due for retaliatory costs must be paid by March 1. Late payments are assessed a 10 percent penalty plus interest.

Retaliatory Costs Tax Credit

When other states impose an assessment for retaliatory costs on Virginia insurance companies, Virginia grants a credit against its license tax on premiums based on the amount of retaliatory costs paid to the other state by the Virginia-based insurance company. In order to qualify for the credit, the taxpayer must apply to the State Corporation Commission and must have maintained a certain employment level. Applications must be signed by a certified public accountant certifying that the company is eligible for the credit.

Taxpayers claiming the retaliatory tax credit are eligible for an annual refund of the credit up to $1.6 million. Applications for the credit and a refund must be filed by March 1. An amended application to claim the credit and receive a refund may be filed within one year that payment is due.

Other Tax Credits

In addition to the retaliatory tax credit, companies subject to the insurance premiums tax may claim the low-income housing credit or the enterprise zone credit. To claim either credit, the taxpayer must apply to the Department of Housing and Community Development (DHCD) and DHCD must certify to the SCC that the taxpayer qualifies for the credit.

Deduction for Amortized Certificates of Contribution

Certain insurance companies that are licensed in Virginia are required to become a member of one of two guarantee associations: (1) the Virginia Life, Accident, and Sickness Insurance Guarantee Association or (2) the Virginia Property and Casualty Insurance Guarantee Association. These associations provide payment of covered claims to reduce the financial loss to claimants and policyholders resulting from the insolvency of a member insurance company.

Members of these associations are required to pay an annual assessment. Any insurer who pays the required assessment receives a certificate of contribution for the amount of the assessment. This certificate of contribution may be treated as an asset by the insurer and amortized over ten years at a rate of ten percent per year.

An insurance company that chooses to amortize a certificate of contribution is entitled to deduct the amortized amount from the insurance premiums tax. However, if any amortized amount is subsequently refunded by the guarantee association, the insurer must repay the amount previously deducted from the insurance premiums tax. Additionally, if the SCC determines that the association is not diligently pursuing available measures of recovery, insurers will not be permitted to claim any amounts amortized during that period.

Tax Imposed on Surplus Line Brokers

Every licensed surplus lines broker is required to pay the insurance premiums tax for each policy of insurance procured during the preceding calendar year with an insurer not licensed to transact insurance business in Virginia. Any surplus lines broker whose annual insurance premiums tax liability is expected to exceed $1,500 must file a quarterly report with the SCC and make estimated payments. To comply with a recently enacted federal law, the Nonadmitted and Reinsurance Reform Act, Title IX of the Wall Street Reform and Consumer Protection Act, this bill ensures that the tax is based on the direct gross premium income from Virginia insured.

Additional Assessments Collected by the SCC

As part of the process of collecting the insurance premiums tax, the SCC also collects a maintenance assessment. The rates for this assessment are set by the SCC and the proceeds are used to fund the regulatory processes for the insurance industry. The SCC also collects other miscellaneous assessments that are used to provide revenues to special funds such as the Fire Programs Fund. The total revenue collected by the SCC in Fiscal Year 2010 was approximately $460 million, with $390 million coming from the premiums tax. Revenue from the insurance premiums tax is split one-third to the Priority Transportation Fund and two-thirds to the General Fund.

Processing of Returns

The SCC reports that approximately ninety-five percent of the payments for this tax are processed electronically through a “lock box” at a bank under contract with the Virginia Department of the Treasury to provide such services. While the payments are done electronically, however, much of the data related to these payments is sent to the SCC from the bank in paper form. In addition to the data received from the bank and through the returns that are sent by insurance companies, the SCC processes data that it receives from and provides to multiple sources, including the National Association of Insurance Commissioners (“NAIC”) and Sircon, Inc., which is a private contractor providing insurance processes and related services to the Bureau of Insurance.

Annual Report to the Department of Medical Assistance Services

The Department of Medical Assistance Services (DMAS) administers the Virginia Family Access to Medical Insurance Security Plan Trust Fund which consists of, among other sources, the premium differential of all eligible contracts. This premium differential is equal to 0.75 percent of the direct gross subscriber fee income derived from such contracts and the amount of license tax revenue generated with respect to these contracts. The SCC is currently responsible for submitting an annual report to DMAS by June 30 that calculates the premium differential for the immediately preceding year.

Administration of Taxes by TAX

TAX currently administers an individual income tax, a corporate income tax, a sales and use tax, and various other taxes. Several of the taxes administered by TAX have revenue dedicated to other sources. For instance, TAX administers the Motor Vehicle Fuel Sales Tax for the Northern Virginia transportation districts, as well as the Communications Sales Tax, the revenue of which is distributed to local governments. TAX is equipped to efficiently process a high volume of returns and has systems that can correlate multiple returns for a taxable period, such as estimated payments, original returns, and amended returns.

TAX is currently responsible for forecasting the revenue generated by the insurance premiums tax, but does not handle any of the processing, collections, or audit responsibilities associated with the insurance premiums tax.

The Governor's Commission on Government Reform and Restructuring recommended the transfer of administration of the insurance premiums tax from the SCC to TAX as a way of eliminating duplicative service delivery methods. During its study, the Commission found that the insurance premiums tax has a structure similar to the corporate income tax administered by TAX in that both taxes require taxpayers to file annual returns and make quarterly estimated payments. Additionally, both the insurance premiums tax and corporate income tax are major sources of General Fund revenue and TAX already includes revenues from the insurance premiums tax in its official forecast.

Proposed Legislation

This bill would transfer the administration of the insurance premiums tax from the SCC to TAX. This would include the processing of tax returns, as well as the handling of related payments and billing. TAX would also provide customer service functions and perform the collections and auditing duties.

TAX would also be responsible for administering the retaliatory cost assessment on certain foreign insurance companies, as well as the retaliatory costs tax credit for domestic insurance companies. This bill would also require TAX to submit the annual premium differential report to DMAS.

The SCC would continue to be responsible for the licensing of insurance companies. In the event that a taxpayer fails to pay the insurance premiums tax, this bill would continue to allow the SCC to suspend or revoke the insurer's license upon notification from TAX.

The SCC would also continue to administer the annual maintenance fund assessment, as well as assessments for the Fire Programs Fund, the Dam Safety, Flood Prevention and Protection Assistance Fund, the program to reduce losses from motor vehicle thefts, and the program to reduce losses from insurance fraud.

To comply with a recently enacted federal law, this bill would require that payments be made by insurers based on the direct gross premium income derived from Virginia policyholders. This bill would also require that every surplus line broker report the direct gross premium income derived from Virginia policyholders by March 1 of each year. A fine of $50 per day would be imposed for the failure of a surplus lines broker to file this report and a payment penalty equal to 10 percent of the tax and interest due would apply if a surplus lines broker fails to pay the tax by March 1. This bill would also require insurance lines brokers to pay an annual maintenance fund assessment and any related penalties.

Because the sharing of information between the SCC and TAX is essential to the effective administration of the insurance premiums tax, this bill would allow TAX and the SCC to exchange information.

This bill would be effective for taxable years beginning on and after January 1, 2013, except that certain provisions related to surplus lines brokers would be effective July 1, 2011.

This bill was recommended by the Governor's Commission on Government Reform and Restructuring.

<u>Similar Legislation</u>

House Bill 2335 and **Senate Bill 1359** would increase the amount of refund that certain insurance companies could receive from the retaliatory costs tax credit.

House Bill 2283 and **Senate Bill 1365** would create insurance premiums tax credits for investments in Virginia small businesses.

House Bill 2286 would require the collection of insurance premiums taxes from surplus lines brokers for direct gross premium income derived from Virginia policyholders.

cc : Secretary of Finance

Date: 1/29/2011 KLC
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