May 1, 2013

Joe Huddleston
Cory Fong
Executive Committee
Multistate Tax Commission

This correspondence is submitted on behalf of the American Council of Life Insurers, the American Insurance Association, the Property Casualty Insurers Association of America, the National Association of Mutual Insurance Companies and the America's Health Insurance Plans ("The Trades"). The Trades reiterate our strong objections to the continuation of the Non-Income Taxpayer Project ("The Project"). The Trades have previously submitted numerous letters and documentation over the course of this project raising strong substantive and process-related objections to The Project and do so again as attachments to this correspondence.

As you are aware, The Project started at the request by the Massachusetts Department of Revenue more than four years ago. During the more than four years, The Trades have repeatedly requested that their serious concerns be researched and addressed by the Multistate Tax Commission ("MTC") and its Uniformity Committee. This has not occurred despite the Executive Committee sending the model statute back to the Uniformity Committee to do exactly that last summer. Instead all that occurred were two revisions to the statute which do not alter The Trades' thinking or strong opinions about this project as articulated in prior submissions.

The Trades continue to believe that if there are any issues of "tax equity" here, as the MTC asserts, they relate to the substantially greater state tax burdens imposed on the insurance industry by the current insurance tax system and new tax inequities that the model would create. With the issue of "tax equity" at this project's core, The Trades believe the project inappropriately ventures into the policy arena and as such should be terminated. Such matters are instead the purview of state legislatures and policy-makers.

It is worth noting that since the Massachusetts Department of Revenue requested the MTC's assistance four years ago, legislation similar to the model statute has been proposed on several occasions and has been rejected by the Massachusetts legislature. Further no state has determined a need for such a proposal, instead they have dealt with any perceived inequities using methods currently available to them without drastically changing fundamental state policy decisions about the taxation of insurer income as The Project would. The Trades have provided to the Uniformity Committee examples of how any perceived inequity could be handled using existing statutes in place in various states. (That "Existing Tools" document is attached for your reference as well.)

We urge the Executive Committee to carefully review all the public comments, testimony and documents that have been generated during The Project, including comments by the NAIC (through Pennsylvania's Deputy Insurance Commissioner and the NAIC's senior legal staff) and Professor Richard Pomp. No state, including Massachusetts has proposed, much less enacted, legislation even similar to what the MTC Project is proposing. Further, there are a number of issues that the MTC has not addressed. For all these reasons, The Trades respectfully urge the Executive Committee to discontinue The Project.

CC: Shirley Sicilian, General Counsel
Sheldon Laskin, Counsel

AMERICAN COUNCIL OF LIFE INSURERS
AMERICAN INSURANCE ASSOCIATION
PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

February 19, 2010

Dear Chairman Miller:

The above trade associations ("the Trades"), representing the majority of the life and property and casualty insurance industry, urge you not to adopt the "Draft Statute to Address Income Earned By Entities Not Subject to Income Tax Derived from Ownership Interest in Passthrough Entity," released on November 20, 2009.[1] The Trades believe that the Draft Statute has been subject to insufficient outside input and rests on questionable and unproven assumptions. In several respects, these assumptions can be evaluated only with input from state insurance regulators.

The Trades would welcome the opportunity to comment on the Draft Statute and the Staff Analysis on which it is based, but it is not the purpose of this letter to provide such comment. Rather, our intent here is simply to state why we believe that the Draft Statute is not ready to receive the imprimatur of your Subcommittee (much less the MTC or the states).

The Uniformity Subcommittee has not had an opportunity to hear from the insurance industry or its regulators about the specific implications of the Draft Statute. It is true that insurance industry representatives met with the Subcommittee in Santa Fe on July 28, 2008 (and informally prior to this meeting). But at that time, the Subcommittee was in the early stages of considering eight diffuse options to address three distinct issues. At the time the industry was heard, there was no clear definition of the perceived problem, much less the suggested remedy. It was not until the Subcommittee met in July of last year that it focused attention on the present issue and it was not until November that the Draft Statute was released. To the best of our knowledge, there has been no consultation on the Draft Statute with stakeholders (e.g., the insurance industry, state insurance regulators, small business investment interests, and other affected industries) or independent experts (e.g., Professor Richard Pomp, a frequent advisor to the MTC, who has studied the state corporate income tax and insurance tax systems). The Trades have offered to organize a panel to provide the Subcommittee with outside, expert input, including state insurance regulators and Professor Pomp.[2]

This process has resulted in a Draft Statute that rests on two stated assumptions (as applied to the insurance industry): first, that there are "serious tax equity issues" which must be addressed by taxing certain insurer investment income; and second, that the Draft Statute can be adopted without impairing the states' longstanding choice for taxing insurance companies (i.e., the nationwide premium and retaliatory tax system). To date, however, there has been no showing that either of these assumptions is sound.

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[1] The Draft Statute is appended to a staff and working group memorandum to the Uniformity Committee, Income and Franchise Tax Subcommittee, dated November 20, 2009. This memorandum was the latest in a series of staff memoranda relating to this issue (and other issues) spanning roughly one year (the others are dated September 30, 2009, March 6, 2009 and November 7, 2008). These memoranda, prepared by MTC staff in coordination with a small working group, are referred to herein, individually and collectively, as the "Staff Analysis."

[2] As we reported to MTC staff, this proved impossible for the upcoming March MTC meeting owing to prior commitments of several invitees.

“Serious Tax Equity Issues”

Premium tax, imposed on a base of gross underwriting receipts, together with retaliatory tax, is the chosen tax system for the privilege of conducting the insurance business in virtually all jurisdictions.[3] The Staff Analysis (in considering one of eight options for taxing insurer income)[4] references economic studies proving that this system consistently yields far more revenue than an income-based tax, but then dismisses the importance of this factor, as follows:

> Of course, in the case of insurance companies, a simple comparison of the revenue generated by the gross premium tax and a hypothetical income tax ignores the fiscal effects of tax avoidance under the current gross premium tax regime. It also ignores the equity issues raised by allowing non-insurance affiliates of insurance companies to operate tax free while taxing similar companies that are not affiliated with insurance companies.

In fact, economic studies (done over decades by and for the states and industry) generally do take account of what the Staff Analysis refers to as “tax avoidance”; i.e., the fact that insurer investment income is not taxed under the gross premium tax system (to an insurer or pass-through investment entity).[5] These studies, many of which rely on the calculation and comparison of effective income tax rates on the insurance industry and income tax-paying industries, consistently show that the insurance tax burden (and resulting state revenues) is far greater than it would be under a corporate income tax system. The Staff Analysis, which focuses on slices of investment income that are outside the gross premium tax base, fails to explain how the perceived “equity issues” leave the states (or any other parties) aggrieved, or to fairly evaluate the most urgent and obvious equity issues for the insurance industry (and policyholders) in this broader context.

Significantly, the Staff Analysis seems to implicitly recognize that the underlying issue here is the states’ choice of the premium and retaliatory tax system for this industry, concluding that the current economic crisis “may not be a propitious time to replace a tax based on gross premiums with one based on net income.” Not addressed by the Staff Analysis, however, is why the current economic crisis presents the “propitious time” to impose an additional tax on this industry. Nor could the Staff Analysis credibly address this issue without hearing from state insurance regulators.

Implications for Current State Insurance Tax System

The Staff Analysis fails to consider whether the current insurance tax system can survive, as both a technical and political matter, the advancing encroachment of an income tax system (via MTC projects relating to forced combined reporting and now, the Draft Statute and multiple other options for taxing insurer income).

The Staff Analysis repeatedly references the need to survey whether domestic insurers in the roughly seven states that subject insurers to income tax are subject to retaliation against this tax

[3] Only Oregon taxes insurers under an income-based “excise tax” (but not a premium tax) and a retaliatory tax. Only Hawaii has not adopted a retaliatory tax.
[4] Staff Memorandum dated March 6, 2009 at pages 2-3.
[5] In Missouri, for example, studies done by Dr. Edward H. Robb (an economist who led the University of Missouri College of Business and Public Administration Research Center, and later, Edward H. Robb Consulting) disclosed that insurance companies “paid…approximately 20 times the average liability of the non-financial corporations and nearly eleven times the average liability of other financial institutions” and paid $164.4 million in premium taxes, but would have paid only $46.3 million had they been subject to the State’s income and franchise tax system instead. *2003 Taxation of the Insurance Industry in Missouri* (Edward H. Robb Consulting 2003). *See also Taxation of the Insurance Industry in Missouri* (Dr. Edward H. Robb, January 1992).

when they do business in other states. However, the Trades have seen no discussion of the results of this survey.

While it was retaliatory tax risks that first caused Massachusetts to refer this project to the MTC, the Staff Analysis fails to take account of any empirical evidence relating to these risks (or even of diverse state retaliatory tax statutes and practices). Instead, the Draft Statute seeks to avoid these risks by creating a fiction; that a pass-through entity is not a pass-through entity if it is owned by an investor that is an insurance company. But the Staff Analysis fails to consider why other states should respect this fiction when it is created by an insurer's home state for the sole and express purpose of avoiding retaliatory taxes (a substantial source of revenue for lower-tax states) in these other states. And beyond the risks of states retaliating, the Staff Analysis fails to consider the implications for the state insurance tax system (and the states) if states *do* retaliate against the Draft Statute.

The Staff Analysis fails to consider how the Draft Statute can be reconciled with the letter and intent of state statutory and constitutional "in lieu" clauses. These clauses represent an implicit bargain that recognizes the disproportionately high tax burden imposed by the current state insurance tax system by providing that the taxes imposed by this system are in lieu of other taxes on insurer income and receipts. Nor does the Staff Analysis consider the impacts of the Draft Statute on investment decisions or on the extensive system of state premium tax credits, which are designed to encourage a variety of in-state insurer investments (e.g., in partnerships).

Apart from these tax-related omissions, there is a broader issue here. The Staff Analysis fails to consider whether the Draft Statute puts the current insurance tax system at risk. The relative merits of the current system and the corporate income tax system are subjects of debate within the insurance industry, with some preferring the predictability of the current system and others preferring to level the playing field among industries. Making these two tax systems progressively additive would provide economic and political impetus (and equitable underpinning) for a unified industry to advocate the choice of one system or the other. And here again, the input of state insurance departments, many of which depend on the reliable and generally-growing revenue stream provided by premium taxes, is essential.

In sum, the Trades believe that the Staff Analysis rests in large part on unfounded, internal assumptions. These assumptions have yielded a Draft Statute that could be self-defeating for the states in the long-term. If there is abuse in this area, the Trades reiterate both our belief that it is isolated and our readiness to assist the MTC in developing appropriate solutions to address it. But to adopt the Draft Statute on the record provided by the Staff Analysis to date, would be, at best, premature.

Respectfully submitted,

AMERICAN COUNCIL OF LIFE INSURERS
AMERICAN INSURANCE ASSOCIATION
PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

cc: Ted Spangler, Chairman, Uniformity Committee

Joe Huddleston, Executive Director
Shirley Sicilian, General Counsel
Sheldon Laskin, Counsel

AMERICAN COUNCIL OF LIFE INSURERS
AMERICAN INSURANCE ASSOCIATION
PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

July 22, 2010

Dear Chairman Miller:

The undersigned trade associations ("the Trades") together represent the great majority of the life insurance and property and casualty insurance industries. We appreciate the opportunity to provide additional comments concerning the Project Regarding Income Earned by Non-Corporate Income Taxpayers Derived from Ownership Interest in a Partnership or LLC (the "Project").[1] We appreciate also the opportunity to speak at the upcoming meeting of the Income and Franchise Tax Uniformity Subcommittee (the "Subcommittee") of the Uniformity Committee of the MTC on July 25.

These comments were originally prepared in response to a Draft Statute posted to the MTC's website in February 2010 (the "Draft Statute"). However, on July 15, two new and revised versions of the Draft Statute (the "Revised Draft Statute") were posted to the MTC's website and will, we assume, be presented to the Subcommittee for the first time at the July 25 meeting. Although we have attempted to react as quickly as possible and have included our initial thoughts with respect to the Revised Draft Statute below, we have not yet had time to undertake a thoughtful discussion regarding the full extent of the Revised Draft Statute. Should the Subcommittee remain committed to the Revised Draft Statute following its initial consideration at the July 25 meeting, we would request a further opportunity to address the Subcommittee regarding this matter.

Summary of Comments. We urge the Subcommittee to reject both the Revised Draft Statute and the Draft Statute (collectively, the "Draft Statutes") for at least the following reasons:

1. The Revised Draft Statute represents a **fundamental expansion** of the Project that would have **dramatic and unfair consequences** for insurance companies and their policyholders nationwide.

2. The Draft Statutes are based on a faulty premise. **Insurance company taxpayers pay higher taxes than non-insurance corporate income taxpayers.**

3. The Draft Statutes **discriminate** against pass-through entities depending on what type of entity owns the majority interest, creating **new inequities**, inconsistencies, and controversies.

4. Any concern among Subcommittee members regarding "abusive" transactions is ill-founded. **Insurance companies are subject to extensive state regulation that creates strong incentives for investment decisions to be driven by nontax business considerations.** States already possess ample tools to combat transactions perceived as abusive.

5. Although the Subcommittee has itself identified several areas requiring further study, to the best of the Trades' knowledge such research has not been conducted.

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1 These comments are intended to supplement our submissions dated February 19, 2010 and March 23, 2010. Our prior comments were based on previous drafts of the Draft Statute, including a draft dated February 19, 2010.

Background

The Draft Statute.[2] Under the Draft Statute, whenever an insurance company owns at least a 50% ownership interest in a "pass-through entity" engaged in a trade or business other than an insurance trade or business, the pass-through entity becomes subject to tax on the investment income passed-through to the insurance company. Although the Subcommittee's discussions to date have focused on what were described as abusive transactions, a recent memo authored in support of the Draft Statute states that the "lack of a tax avoidance motive is immaterial to the general purpose" of the Draft Statute, because the purpose of the Draft Statute is "to address an inequity in the income tax treatment of pass-through income generated by separate business entities that is entirely the result of the fact that some companies are not subject to state income tax."[3]

The Revised Draft Statute. The Revised Draft Statute would impose tax on a pass-through entity if 50% or more of the interests in the entity are owned by an insurance company or any other entity not subject to income tax except an organization exempt under Section 501 of the Internal Revenue Code. The application of the Revised Draft Statute is not limited to pass-through entities engaged in a trade or business.

Detailed Analysis

1. The Revised Draft Statute represents a fundamental expansion of the Project that would have dramatic and unfair consequences for insurance companies and their policyholders nationwide.

In addition to the concerns expressed in the remainder of these comments with respect to both Draft Statutes, the Revised Draft Statute suffers from three fatal flaws, detailed below.

First, the Revised Draft Statute is not limited in its application to pass-through entities engaged in a trade or business. Thus, the Revised Draft Statute would impose tax on passive investments such as investment funds held by insurance companies in support of their obligations to pay policyholder claims. Imposing tax on the investment income of insurance companies would represent a fundamental shift in the long-standing nationwide system of state insurance taxes, which rests on the foundation of premium taxation, retaliatory taxation and constitutional and statutory "in lieu" protections, and has been the states' chosen system for taxing the privilege of conducting the insurance business nationwide.[4]

The underwriting and investment aspects of the insurance business are inextricably interrelated. As stated by the U.S. Supreme Court (in describing a life insurer's underwriting and investment receipts):

> An insurance company obtains most of its funds from premium paid to it by policyholders in exchange for the company's promise to pay future death claims and other benefits. The company is also obligated to maintain reserves, which, if they are to be adequate to pay future claims, must grow at a sufficient rate each year. The receipt of premiums necessarily entails the

[2] *See* Alternative Draft 1, Memo from Sheldon Laskin to the Subcommittee, dated February 19, 2010.

[3] Memo from Sheldon Laskin to the Subcommittee, dated June 11, 2010, fn 4.

[4] Oregon is the only state that taxes insurers under a net income-based "excise" tax, but not a premium tax.

> creation of reserves and additions to reserves from investment income. Thus the insurance company is not only permitted to invest, but it *must* invest; and it *must* return to the reserve a large portion of its investment income...

U.S. v. Atlas Life Insurance Co., 381 U.S. 233, 247 (1965). Although the premium tax component of the insurance tax system is based on gross underwriting receipts, this is a *comprehensive tax system on the privilege of engaging in an insurance business*, in all of its aspects, in the states. Thus, states have heretofore deemed the insurance tax system sufficient to tax the entire insurance business, i.e., its underwriting income (premiums) and its investment income.[5]

The inappropriateness of superimposing on this system a new tax on investment income is best illustrated by a simple example comparing a non-insurance corporate income taxpayer with an insurance company taxpayer. To make the example as objective as possible, it is based on the highly unlikely assumption that both taxpayers have the same amount of investment income. In reality, however, as a general rule, investment income would make up a much higher portion of the overall income of an insurance company than a non-insurance company, such that the proposal would result in a significantly higher tax burden on the insurance company than the non-insurance company.

	Non-Insurance Co.	**Insurance Co. current law**	**Insurance Co. after Revised Draft Statute**
Gross Receipts/Premiums	$1,000	$1,000	$1,000
Less: expenses	($950)	($950)	($950)
Investment income from pass-throughs[6]	$100	$100	$100
Net income before taxes	**$150**	**$150**	**$150**
Less: Taxes			
Income tax (7%)	$10.50	$0	$0
Income tax on pass-through entity (7%)	$0	$0	$7
Premium tax on gross premiums (2%)	$0	$20	$20
Total tax paid	**$10.50**	**$20**	**$27**

In this simple example, under existing law, an insurance company subject to 2% premium tax pays nearly 200% the amount of tax that a non-insurance company taxpayer subject to a 7% income tax with the exact same receipts and expenses would pay ($20 vs. $10.50). Subjecting the insurance company to the income tax on its investment income heightens the disparity, increasing the burden on the insurance company to nearly 260% ($27 vs. $10.50).

It is no solution to suggest that insurance companies could merely hold investment assets directly, rather than in partnership or limited liability company form, in order to avoid the application of this onerous and inequitable rule. Insurance companies hold investment assets in a variety of legal forms for legitimate and important business reasons. For example, an insurance company might choose to create a medium-term corporate bond fund to purchase corporate debt. The insurance company might hold 99.9% of the interest in the fund, using the remaining interest to provide incentive compensation to personnel responsible for managing the company's medium-term corporate bonds. Imposing income tax on the income earned by the insurance

[5] Although some states supplement the premium tax with an income tax, insurers are generally permitted cross-tax credits or caps.

[6] Example is for purposes of illustration and does not necessarily reflect the proportion of investment income that might be earned by an insurance company from a investment held in pass-through entities.

company from the fund could impair the company's ability to meet its obligations to pay policyholder claims,[7]

Finally, the Revised Draft Statute could result in additional tax burdens being imposed on the some of the nation's most vital non-insurance regulated industries, including financial institutions, telecommunications companies, and public utilities. These stakeholders have not had the opportunity to address the Subcommittee, and it would be imprudent for the Subcommittee to act with respect to the Revised Draft Statute without considering the effect of adopting a new tax on these industries.

2. The Draft Statutes are based on a faulty premise. Insurance companies bear a significantly higher burden of state business taxes than non-insurance businesses.

Both of the Draft Statutes purport to be based on the notion that the current system results in an inequity, such that exempting insurance companies from the income tax somehow results in insurance companies bearing a lower tax burden than non-insurance corporate taxpayers. As stated above, the purported purpose of the Draft Statutes is "to address an inequity in the income tax treatment of pass-through income generated by separate business entities that is entirely the result of the fact that some companies [*i.e.*, insurance companies] are not subject to state income tax."[8] The notion that the current system results in "inequity" that favors insurance companies is demonstrably incorrect, as illustrated by the example discussed above. The results of that example are confirmed by multiple studies conducted by states and economists over decades. It is universally accepted in the academic and economic communities – and recognized by the MTC itself[9] -- that the insurance tax system imposes a tax burden that is many multiples of the tax burden imposed on non-insurance corporate taxpayers, or that would be imposed on the insurance industry if it were subject to income taxation in lieu of the current insurance tax system.[10]

Professor Martin F. Grace concisely begins his study of the relative burden imposed by the state life insurance tax system (*Excessive State Taxation of the Life Insurance Industry: The Case for Reform* (December 23, 2003)) with the simple finding that "[t]he insurance industry is overtaxed."[11] Others who have compared the insurance and corporate income tax systems for states and/or industry agree. The following illustrative excerpts from various studies represent only a handful of examples of the relevant research (examples confined to member states of the Subcommittee in the interest of brevity, emphasis supplied):

- ***California (2008).*** "Economists who have examined state insurance taxes have found that a simple comparison of premiums to net income suggests that **insurance premiums tax revenues are several times higher than a profits tax** would produce...This is also true in California..." *Investment Income and the Insurance Gross Premiums Tax* (California Legislative Analyst's Office at page 4).

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7 Indeed, the burden of such tax could fall directly on policyholders where an insurance company holds investment funds in a separate account supporting such things as variable life insurance contracts.

8 Memo from Sheldon Laskin to the Subcommittee, dated June 11, 2010, fn 4.

9 The March 6, 2009 and November 20, 2009 memos to the Subcommittee recognize that Minnesota repealed its income tax on insurers because the premium tax "consistently yielded much higher revenue."

10 It also is well accepted that the insurance tax system generates a reliable, generally growing source of revenue for the states, far in excess of the revenue that would be generated by taxing insurer income, and that remains steady during periods of economic stress and reduced corporate profitability.

11 It should be noted that Professor Grace is considered a credible source by MTC staff. *See* Memo from Sheldon Laskin to the Subcommittee, dated February 19, 2010.

- ***California (2003).*** "All of the available evidence shows that California's tax laws currently impose a **much heavier burden on insurance companies** than on companies in other industries." *The Taxation of Insurance in California* (Hamm, Fortenbaugh, Schmidt, Johanson at LECG Economics and Finance at page iii).

- ***California (1991).*** "The income-based tax burden on these property/casualty insurers [companies writing between 42.3% and 50.1% of the total California market between 1984-1989] ranged from a low of 16.9% in 1987 to a high of 53.9% in 1985 and **exceeded the tax rates imposed on other industries in every year**." *California Taxation of the Property/Casualty Insurance Industry* (Hofflander, Nye, Charlesworth, Brydon at Stanford Consulting Group at page i).

- ***California (1990).*** "These figures illustrate that the **tax burden imposed on the life insurance industry** by the State of California **greatly exceeds that imposed on other California industries**." *Taxation of the California Life Insurance Industry* (Hofflander, Nye and Charlesworth at page 5).

- ***Florida (2006).*** "The insurance premium tax has grown in importance as a source of tax revenue in recent years as annual intangibles tax and estate tax revenues have been reduced to zero. **Because of its growing importance as a revenue source, proposals to change this tax warrant careful scrutiny**." *An Overview of Florida's Insurance Premium Tax, Report No. 2007-122* (Prepared by Committee on Finance and Tax for Florida Senate at page 17).

- ***Florida (1991).*** "The P&C industry was subject to an **effective tax rate of 33.5** percent in Florida over the five-year period from 1985 to 1989 (using the statutory income measure which is applied for the purpose of insurance regulation). The effective tax rates for the comparison industries in the manufacturing, retail trade and banking sectors ranged from 5.6 to 9.9 percent over the same period." *Comparative Analysis of the Taxation of the P&C Insurance Industry in Florida* (Price Waterhouse at page i).

- ***Florida (1990).*** "There is a wide acceptance and a statistical basis for determining that each one percent of the insurance premium tax (a gross receipts tax) is equivalent to a 20.4% net income tax." *Report of the Florida Insurance Premium Tax Task Force to the Florida Legislature* (at page 4).

- ***Massachusetts (1997).*** "Taxes as a percentage of profits are **higher in the insurance industry than in any other industry** in the state and greater than on other financial services." *The Effect of State Tax Policy on the Insurance Industry In Massachusetts* (Prof. Craig L. Moore, University of Massachusetts at page 7).

- ***Missouri (2003).*** "Banking and other credit institutions paid an average of only $8000 in 2002. Insurance companies, in comparison, paid an average of about $86,400 per company, **approximately 20 times the average liability of the non-financial corporations** and nearly eleven times the average liability of other financial institutions." *2003 Taxation of the Insurance Industry in Missouri* (Dr. Edward H. Robb at page 2).

- ***Missouri (1992).*** "As can be seen from the data...the insurance industry bears a vastly disproportionate tax burden. Nonfinancial corporations with positive net income paid net Missouri income taxes of $206.5 million in fiscal year 1991. This amounts to an average liability of approximately $7,100 per return. These corporations also paid $57.5 million in franchise taxes, an average of about $2,100 per corporation – a total of less than $10,000 from both taxes. Insurance companies, in comparison, paid $124.4 million, an average of about $74,000 per company, approximately **8 times the average liability of the nonfinancial corporations**." *Taxation of the Insurance Industry in Missouri* (Dr. Edward H. Robb at page 2).

- ***Texas (2004).*** "The premium tax and other state and local taxes impose a **significantly higher tax burden** on property/casualty insurers that the tax they would pay if taxed as general corporations. This study estimates the property/casualty insurers paid $334 million more in taxes in FY 2003 than they would have if they were taxed as general corporations." *Tax Burden Imposed on Property/Casualty Insurers in Texas* (Ernst & Young at page 1).

- ***Texas (2004).*** "Because the premium tax applies to a tax base much larger than the base for the franchise tax, the premium tax combined with other state and local taxes, imposes a **significantly higher tax on life/health insurers** than the tax they would pay if they were taxed as general corporations...[W]hile general corporations are subject to a maximum rate of 4.5 percent of net taxable earned surplus (net income), the premium taxes paid by life/health insurers are equivalent to 17.1 percent of net taxable earned surplus." *The Excess Taxation of Life/Health Insurers in Texas* (Ernst & Young at pages 1-2)

- ***Texas (1998).*** "Price Waterhouse studies prepared in 1991 and 1997 found that the effective tax rate imposed on the P&C industry in Texas was, on average, **4 to 8 times higher than for five other representative industry groups** in Texas over the 1985-1989 and 1992-1993 periods." *Taxation of the Texas Property and Casualty Insurance Industry* (Price Waterhouse at page E-1).

The academic and economic literature is compelling: the current system imposes a higher tax burden on insurance company taxpayers than non-insurance company taxpayers. This burden is imposed on the privilege of engaging in the insurance business – including both underwriting and investing – in a state. The premise of the Draft Statutes, therefore, is false. There is no "inequity" in the current insurance tax scheme that favors insurance companies.

3. The Draft Statutes discriminate, creating new inequities.

However, enactment of either of the Draft Statutes would create substantial inequities where none currently exist, because the Draft Statutes discriminate against pass-through entities owned by entities that are not subject to an income tax (e.g. insurance companies) in favor of pass-through entities owned by companies that are subject to an income tax.[12] The inequities that would be created by the Draft Statutes have not been included within the written analysis prepared to date, have not been considered by the Subcommittee, and are fundamentally unfair. Specifically:

First, the Draft Statute discriminates against insurance companies in favor of non-insurance corporate income taxpayers because non-insurance corporate income taxpayers are permitted to use losses in pass-through entities to offset their income or income earned by other pass-through entities in computing the amount of income tax due. Under the Draft Statute, if a pass-through entity has income, the income would be taxed at the pass-through level to the extent the entity is owned by an insurance company, regardless of whether the insurance company also owns other pass-through entities that have experienced losses. A non-insurance

[12] Note that for purposes of this letter, only the effect of the Draft Statutes on insurance companies will be discussed. As noted previously the Revised Draft Statute applies to more industries than insurance companies and the Subcommittee should solicit their comments as well.

corporate income taxpayer, on the other hand, would be able to offset the pass-through entity's income using either losses earned by other pass-through entities or using its own losses.

Second, the Draft Statute discriminates against insurance companies because any losses in an insurance company could not be used to offset income earned by the pass-through. A non-insurance corporate income taxpayer, on the other hand, would be able to offset its losses against the pass-through entity's income. Thus, an otherwise unprofitable insurance company would in essence face two different state tax liabilities (i.e., premium and retaliatory tax and a reduction in the pass-through entity's income because of the income tax at the pass-through entity level under the Draft Statutes) and an unprofitable non-insurance corporate income taxpayer would not owe tax at all. The example below illustrates this point using a non-insurance corporate taxpayer with $1,000 of gross receipts, $1,100 of expenses, and $100 of investment income earned through a pass-through entity. The non-insurance corporate taxpayer uses the investment income to offset operating losses, and pays $0 of overall tax. An insurance company with the exact same items, on the other hand, pays $27 of total tax.

Because the pass-through entity's income cannot be offset by an insurer's losses (whether investment or underwriting), even an unprofitable insurance company would bear the economic burden of gross receipts taxes on its premiums (under the existing premium tax statute) and a new tax imposed on the gross amount of its investment income (under the Draft Statute). The non-insurance corporate income taxpayer, however, is only subject tax on net profits, and if profits are $0, the amount of tax imposed is $0.

	Non-Insurance Co.	**Insurance Co. after Revised Draft Statute**
Gross Receipts/Premiums	$1,000	$1,000
Less: expenses	($1,100)	($1,100)
Investment income from pass-throughs	$100	$100
Net income before taxes	**($0)**	**($0)**
Less: Taxes		
Income tax (7%)	$0	$0
Income tax on pass-through entity (7%)	$0	$7
Premium tax on gross premiums (2%)	$0	$20
Total tax paid	**$0**	**$27**

Third, the Draft Statutes discriminate among insurance companies based on the manner in which they choose to hold investments. Under current law, an insurance company is taxed by most states in the same manner regardless whether it owns an investment directly or indirectly (*i.e.,* through an ownership interest in a pass-through entity). As described below in Section 4, decisions regarding how investments of insurance companies should be held are highly sensitive to state regulation of financial investments, and state regulatory laws create incentives to encourage outcomes in the interest of protecting policyholders. State income tax law should not drive business decisions regarding the form of an investment. The Draft Statutes, however, would discriminate against insurers holding investment in pass-through or limited liability form, creating an incentive, for example, for an insurance company to invest in less than a controlling share of any pass-through entity. The Subcommittee might be well advised to coordinate the creation of any incentives relating to the investments of insurance companies with the NAIC.

Fourth, it appears to be intended that the Revised Draft Statute would not be adopted by a state that subjects insurance companies to income taxation. However, this does not appear to be the case with the Draft Statute. Adoption of the Draft Statute by a state that imposes an income tax directly on insurance companies would impose two income taxes on the same investment income, once when earned by the pass-through entity and once when passed through to the insurance company. A non-insurance corporate income taxpayer would not be subject to multiple layers of tax on the same income. Moreover, it is not at all clear how the Draft Statute would be applied in states that (a) only subject certain insurers (*e.g.*, domestic companies) to income tax (*e.g.*, Arkansas, Indiana, Wisconsin), (b) apply reciprocal income tax non-retaliation (*e.g.*, Illinois, Nebraska), (c) provide that income tax is creditable (in whole or part) against premium tax (*e.g.*, Florida, Illinois, Mississippi, Nebraska),(d) provide that premium tax is creditable (in whole or part) against income tax (*e.g.*, Louisiana, New Hampshire), (e) apply caps to combined income and premium tax liability (*e.g.*, Illinois, Nebraska, New York), or (f) impose income tax on bases that are, in whole or part, gross (*e.g.*, Indiana, New Hampshire). Depending on how these issues are addressed, the existing inequities identified above could be aggravated.

4. **Any concern among Subcommittee members regarding "abusive" transactions is ill-founded. Insurance companies are subject to extensive state regulation that requires investment decisions to be driven by nontax business considerations. States already possess ample tools to combat transactions perceived as abusive.**

The primary goal of state regulation of insurance companies is the protection of policyholders. To ensure that an insurance company will have sufficient funds to cover policyholder claims, states exercise stringent financial oversight of insurance companies. Although the purpose of this system of regulation is to protect policyholders, the system operates to prevent insurance companies from engaging in the type of abusive, tax-motivated transactions about which members of the Subcommittee have previously expressed concern in at least the three ways described below.

First, state insurance regulators review the financial aspects of insurance companies on a regular basis, at least quarterly. The rules for financial regulation of insurance companies are promulgated by the National Association of Insurance Commissioners. States must use these rules to maintain their accredited status.

Second, states regulate the investments of insurance companies by applying an investment law with a variety of restrictions (either the NAIC Defined Limits Version or the Defined Standards Version. Under the Defined Limits Version An insurance company may invest only in those investments permitted by statute and only in limited percentages. Under the Defined Standards Version, the capital and surplus of an insurance company and a certain percentage of reserve liabilities must be invested in very conservative investments, and the state applies a "prudent person" approach to investments in excess of a certain threshold. States commonly regulate the investments of insurers in affiliates other companies and subsidiaries, limiting the amount an insurance company may invest in subsidiaries to 10% of the amount of the company's "admitted assets" (*i.e.*, assets that are counted in determining the solvency of the company). Insurance commissioners may enjoin companies from making investments that would violate these restrictions, and insurance companies that violate the restrictions are subject to various penalties, including fines. Thus, because an investment in a controlled affiliate is subject to limits driven by state insurance regulation, it is generally true that the decision whether to make such an investment is driven by nontax, business considerations. .

Third, insurance companies are subject to both fixed minimum capital requirements and so-called "risk-based capital" or "RBC" requirements that operate to discourage companies from holding assets in affiliated entities. RBC requirements are determined through the application of formulas developed by the NAIC that apply various modeling, correlation and discount factors to compare the value of the actual capital held by an insurance company (called "total adjusted capital" or "TAC") to its RBC. When the ratio of TAC to RBC reaches a certain threshold level, state regulatory law permits the insurance regulatory agency to take action ranging from permissive intervention to assuming control of the company. RBC ratios are also relied on extensively by market participants (investors, lenders, rating agencies) as a measure of the financial strength of an insurance company.

In computing an insurance company's RBC ratio, different assets held by the insurance company are included at anywhere from 100% to 30% of their value. For example, debt rated A/a or better is subject to a 0.4% haircut, whereas debt rated B/B is subject to a 10% haircut. These discounts create a strong disincentive for insurance companies to invest in any assets other than highly-rated debt instruments, because of the high discount associated with such investments in the RBC calculation. Because investments other than highly-rated marketable debt are disfavored by the state insurance regulatory scheme, it is generally true that the decision whether to make such an investment is driven by nontax, business considerations.

Finally, members of the Subcommittee have previously expressed concern that certain businesses previously subject to income tax were "restructured" to "shift income" from a corporate income taxpayer into an insurance company exempt from corporate income tax. This concern is ill-founded, again because the state insurance regulatory system creates a strong disincentive to hold assets in an insurance company other than those needed to cover policyholder liabilities. Specifically, state insurance regulatory laws impose restrictions on the ability of an insurance company to pay dividends. Dividends are permitted only up to a certain percentage of surplus, and are only permitted with regulatory approval. Because of this restriction, the decision whether to hold an investment in an insurance company or an affiliate is driven by nontax business considerations.

For all of these reasons, members of the Subcommittee should not be concerned that existing rules permit "abusive" transactions. To the extent that members remain concerned about "stuffing" transactions, state income tax laws already include adequate tools to permit the State to deny companies the tax advantage sought in connection with such transactions.

5. Further research is required.

The Draft Statutes should be rejected because the Subcommittee has not yet investigated several areas of study that the Subcommittee itself identified as necessary research. As members are aware, during the March 2008 meeting of the Subcommittee, Michael Fatale presented a letter from the Commissioner of the Massachusetts Department of Revenue requesting that the Uniformity Committee consider undertaking a project relating to the ownership by insurance companies of "non-insurance businesses" in pass-through entities, due to concern that "the structure is being used for tax avoidance."[13] Mr. Fatale raised the example of an insurance company owning a parking garage. The Commissioner's letter indicated that a proposal relating to this issue had been made in Massachusetts, but that members of the 15-member Study Commission assigned to consider the proposal recommended that the proposal be slated for further study, as they believed the threat of retaliatory taxation "warranted more comprehensive review."[14] Subsequent memos by MTC staff have also suggested a need to conduct a survey of state retaliatory tax practices.

To the best of the Trades' knowledge, the Subcommittee has not conducted a comprehensive review of the threat of retaliatory taxation. As we have previously commented, the Trades have serious concerns that the threat of retaliatory taxation is very real. The Draft Statutes rely on a fiction for the purpose of avoiding insurance retaliatory taxes. This fiction -- that a pass-through entity is a taxable entity – applies only when the pass-through entity is owned by limited, defined entities, including insurance companies. By singling-out insurance companies, the Draft Statutes invite retaliation by the states. Unless the Draft Statute (or Revised Draft Statute) is simultaneously and uniformly enacted in all states (which would be unprecedented), insurance companies domiciled in an adopting state face the likely imposition of retaliatory taxes

13 Letter from Navjeet K. Bal to Jan Goodwin and Joe Huddleston, dated February 12, 2008.

14 Minutes of the March 12, 2008 meeting of the Uniformity Committee, Income and Franchise Tax Subcommittee.

in non-adopting states, placing them at a serious disadvantage relative to other insurers domiciled in non-adopting states and competing in the same market. A non-insurance corporate income taxpayer, of course, would not face these tax or competitive disadvantages, because a non-insurance corporate taxpayer is not subject to retaliatory tax at all.

In addition, further research is needed regarding the insurance regulatory framework. At the July 2008 meeting of the Subcommittee, members expressed concern regarding the use of "restructurings" involving pass-through entities to "shift income" out of a unitary group, and "stuffing" of insurance companies.[15] Concern was also expressed regarding insurance companies moving from "passive" investments into "active" investments. Chairman Spangler noted that from the perspective of an insurance regulator, some of the transactions perceived as abusive might not be abusive, and that it would be helpful to narrow the focus of the Subcommittee to those transactions that were truly abusive.[16]

At the conclusion of the discussion, members agreed that more education was needed, and that several issues needed to be more well-defined, including the use of captives by non-insurance companies, the use of LLCs and partnerships by insurers, and issues relating to various types of insurer investments (so-called "good" investments versus "bad" investments). It was also suggested by members that it might be helpful to hear from state insurance regulators. Although we understand that the Subcommittee did meet with a representative from New York State, it does not appear that insurance regulatory topics were discussed.

Conclusion

The Trades urge the Subcommittee to reject both the Revised Draft Statute and the Draft Statute. We look forward to discussing these comments and our earlier comments with you directly at your upcoming meeting.

Respectfully submitted,

AMERICAN COUNCIL OF LIFE INSURERS
AMERICAN INSURANCE ASSOCIATION
PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

cc: Ted Spangler, Chairman, Uniformity Committee
Joe Huddleston, Executive Director
Shirley Sicilian, General Counsel
Sheldon Laskin, Counsel

[15] Minutes of the July 2008 meeting of the Uniformity Committee, Income and Franchise Tax Subcommittee.

[16] Personal notes of Trade Association representatives.

AMERICAN COUNCIL OF LIFE INSURERS
AMERICAN INSURANCE ASSOCIATION
PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

May 16, 2011

Ms. Loretta King
Multistate Tax Commission
444 N. Capitol Street, N.W., Suite 425
Washington, DC 20001-1538

Re: Comments on MTC's Proposed Statute Regarding Partnership or Pass-Through Entity Income That Is Ultimately Realized By An Entity That Is Not Subject To Income Tax

Dear Ms. King:

The undersigned trade associations ("the Trades") thank you for the opportunity to submit comments on the Multistate Tax Commission's ("MTC's") draft Proposed Statute Regarding Partnership or Pass-Through Entity Income That Is Ultimately Realized By An Entity That Is Not Subject To Income Tax (formerly known as the "Project Regarding Partnership or Pass-through Entity Income on Income Earned by Non-Corporate Income Taxpayers Derived from Ownership Interest in a Partnership or LLC"). We also thank you for the opportunity to have commented on this project as it has been considered by the Income and Franchise Tax Subcommittee (the "Subcommittee) of the Uniformity Committee over the past two years.[1] We represent the great majority of the life insurance and property and casualty insurance industries and the MTC's draft proposed statute is of great concern to us.

Summary Conclusion

For the reasons discussed in detail below, we respectfully submit that the draft proposed statute has not been subject to sufficient investigation and could have serious repercussions if adopted by any state. We therefore recommend that the draft proposed statute not be recommended for adoption by the Commission and instead be returned to the Subcommittee for further study on the matters specified below.

The comment letters previously submitted by the undersigned trades include a detailed discussion of most of the trades' comments. Although we have submitted substantial comments at each stage of this project, with all due respect the undersigned trades do not feel that their comments have been adequately reviewed or evaluated. We therefore would respectfully request that the Hearing Officer consider and respond specifically to each of the comments set forth below.

Description of the Draft Proposed Statute

The Draft.[2] Under the draft proposed statute, when an insurance company owns at least a 50% ownership interest in a pass-through or partnership entity for which deductions would be allowed under Section 162 of the Internal Revenue Code, a portion of the net income of the entity equal to the insurance company's share would be subject to state income tax at the entity level

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[1] These comments are intended to supplement our submissions dated February 19, 2010, March 23, 2010 and July 22, 2010. Our prior comments were based on previous drafts of the Draft Statute, including drafts dated February 19, 2010 and July 15, 2010.

[2] *See* Alternative Draft 1, Memo from Sheldon Laskin to the Subcommittee, dated February 19, 2010.

"as if the entity were a corporation." The draft proposed statute indicates that "to the extent applicable," income attributable to the entity and related tax attributes and activities shall be included in a combined report.

Detailed Comments

1. The Subcommittee Has Not Fully Investigated The Proposal

Since the inception of this project, the Subcommittee has recognized that several aspects of the proposal require further study. The proposal was first presented during the March 2008 meeting of the Subcommittee, when Michael Fatale presented a letter from the Commissioner of the Massachusetts Department of Revenue requesting that the MTC consider undertaking a project relating to the ownership by insurance companies of "non-insurance businesses" in pass-through entities, due to concern that "the structure is being used for tax avoidance."[3] Mr. Fatale raised the example of an insurance company owning a parking garage. The Commissioner's letter indicated that a proposal relating to this issue had been made in Massachusetts, but that members of the 15-member Study Commission assigned to consider the proposal recommended that the proposal be slated for further study, as they believed the threat of retaliatory taxation "warranted more comprehensive review."[4]

As discussed in more detail below, no comprehensive review of the retaliatory tax system was conducted. Nonetheless, the project progressed. In early 2008, members of the MTC staff met with industry representatives, who echoed the concern regarding retaliatory taxation and raised additional concerns.

The project was again discussed at the July 2008 meeting of the Subcommittee, at which the undersigned trades presented their concerns in detail. A representative of the Texas Comptroller's office also made a presentation. Subcommittee members expressed concern regarding the use of "restructurings" involving pass-through entities to "shift income" out of a unitary group, and "stuffing" of insurance companies.[5] Concern was also expressed regarding insurance companies moving from "passive" investments into "active" investments. Chairman Spangler noted that from the perspective of an insurance regulator, some of the transactions perceived as abusive might not be abusive, and that it would be helpful to narrow the focus of the Subcommittee to those transactions that were truly abusive.[6]

At the conclusion of the discussion, members agreed that more education was needed, and that several issues needed to be more well-defined, including the impact of retaliatory taxation, the use of captives by non-insurance companies, the use of LLCs and partnerships by insurers, and issues relating to various types of insurer investments (so-called "good" investments versus "bad" investments). It was also suggested by members that it might be helpful to hear from state insurance regulators.

[3] Letter from Navjeet K. Bal to Jan Goodwin and Joe Huddleston, dated February 12, 2008.

[4] Minutes of the March 12, 2008 meeting of the Uniformity Committee, Income and Franchise Tax Subcommittee.

[5] Minutes of the July 2008 meeting of the Uniformity Committee, Income and Franchise Tax Subcommittee.

[6] Personal notes of Trade Association representatives.

The Subcommittee did not arrange to meet with state insurance regulators.[7] Nonetheless, the project progressed. The Subcommittee again discussed the project at the July 2009 annual meeting, and in November 2009, a new draft of the model statute was released. In a letter dated February 19, 2010 (attached as Exhibit A), the undersigned trades submitted comments repeating their concerns that the Subcommittee had not yet conducted the analysis necessary to proceed. The undersigned trades later submitted an analysis by Professor Richard D. Pomp, describing "issues of process" in the Subcommittee's development of the draft statute (attached as Exhibit B). The Pomp analysis recommended that the Subcommittee engage in a "thoughtful, careful, and sophisticated analysis, which takes into account the benefits of the current regime, the costs of change, and the law of unintended consequences," and cautioned against "any rush to judgment" on the project.

The analysis recommended by Professor Pomp was not conducted. Nonetheless, the project progressed. In July 2010, two new and revised versions of the draft statute were posted to the MTC's website and presented to the Subcommittee at the July 2010 annual meeting. The undersigned trades again submitted written comments (attached as Exhibit C) articulating numerous concerns about the draft statutes and made a presentation to members at the Subcommittee meeting. At the conclusion of the meeting, the Subcommittee decided to solicit input on particular topics before proceeding.

Following the July 2010 meeting, the undersigned trades corresponded with MTC staff assigned to the project regarding the Subcommittee's desire to hear from state insurance regulators (correspondence attached as Exhibit D). The trades advised MTC staff that the optimal approach would be for a representative or representatives of a member state (rather than MTC staff) to approach insurance regulator(s) directly and offered to work with MTC staff to identify any potential candidates and to support the MTC's invitation. To the best of our knowledge, such invitations were never extended.

Rather, in October 2010, MTC staff produced another memo regarding the project, which contained factually incorrect statements regarding the business of insurance and the investments of insurers. Most notably, the memo concluded (without citing to any authority) that "the nature of the insurance business has changed dramatically over the past twenty-five years. Until relatively recently, insurance companies could not own a controlling interest in a pass-through entity that was actively engaged in a trade or business." The undersigned trades corresponded with MTC staff (correspondence attached as Exhibit E), questioning whether any evidence existed to support the contentions in the memo and urging the Subcommittee to refrain from acting on the basis of inaccurate information, conclusory statements, and minimal outside input. Despite these concerns, the Subcommittee voted to approve the draft statute at its December 2010 meeting.

In March 2011, the draft statute was presented to the Executive Committee, and the undersigned trades once again urged that the proposal had not been fully investigated, and that the proposal should not be approved until the research and analysis identified over the course of the project as necessary had been conducted. Members of the Executive Committee questioned whether such research could be conducted as part of the public hearing process. In response, Executive Director Joe Huddleston assured members that the public hearing process would include the input of state insurance regulators. The undersigned trades are very appreciative of Director Huddleston's support in this regard.

The undersigned trades believe that before the draft proposed statute may be advanced, the Subcommittee must investigate and consider the matters discussed above, each of which has

7 We note that the Subcommittee heard a presentation by Gary Johnson from the Texas Comptroller of Public Accounts and met with a representative of the New York Department of Taxation and Finance. Neither agency regulates the insurance industry.

been identified as necessary by the Subcommittee at various times but none of which has been given due consideration to date. For example, although the Study Commission recommended a comprehensive review of the retaliatory tax issue, no review was conducted despite repeated requests by the insurance industry. Rather, this issue has been summarily dismissed at each juncture with limited inquiry into or understanding of how the draft proposed statute would be applied under each states' individual retaliatory tax law. The Subcommittee has instead offered summary conclusions that retaliatory tax is not an issue by asserting that the tax is imposed at the pass-through entity level and not on the insurer and that there is no case law supporting the imposition of retaliatory tax in situations contemplated by the draft proposed statute. These summary conclusions are flawed. For example, the theory that imposing the tax upon the pass-through entity as opposed to the insurer prevents the imposition of the retaliatory tax is premised upon the supposition that each state will accept at face value that insurers are not subject to tax under the draft proposed statute without any analysis of the legal or economic incidence of the tax under each states' laws. In addition, no inquiry has been made concerning whether a state could take the view that the "burden" of the tax (an important concept in many states' retaliatory tax statutes) was imposed on an insurer under the draft proposed statute for purposes of applying that state's retaliatory tax. Lastly, the absence of a comprehensive review is apparent in the Subcommittee's failure to provide direct responses to questions/testimony offered by the industry as well as by Professor Pomp. The undersigned trades therefore respectfully request that the draft statute be sent back to the Subcommittee for further study, including in particular a comprehensive review of the retaliatory tax issue.

2. The Subcommittee Has Not Considered the Administrative Problems Created By The Proposed Draft Statute

As described above, the draft proposed statute would impose an entity-level tax on certain partnerships and pass-through entities. The draft does not, however, contemplate the administrative and equitable difficulties that are created for the state or for non-insurance company owners of such an entity. For example, imagine that an insurance company owns 90% of the interests of a partnership that acts as an insurance claims administrator for both the insurance company and unrelated third parties. The remaining 10% of the partnership is owned by individual officers and employees that manage the administrator (the "Managers"). Under the draft proposed statute, if the partnership earns $1000 of income, $900 of that income will be subject to tax at the partnership level. The draft proposed statute does not indicate, however, how the tax is to be administered. Many partnership agreements include pro rata allocations of all items, meaning that the Managers' shares could be reduced to account for the tax due at the entity level. Moreover, the draft proposed statute does not indicate whether, where the tax is not paid by the partnership itself, the tax will be collected solely from the insurance company partner or also from the Managers. Finally, it is not clear whether states have systems in place to administer entity-level taxes on an allocable share of income from partnership and pass-through entities. For example, if the draft proposed statute were enacted, it would be expected that the partnership entity would make estimated tax payments relating to the share of income allocable to an insurance company owner (because the tax is imposed at the entity level). However, the draft proposed statute provides that where applicable, income attributable to the insurance company owner and related tax attributes and activities are to be included in a combined report. This suggests that estimated tax payments made by the partnership entity would later be claimed by the non-insurance group affiliated with the insurance company in connection with the group's filing of a combined report, as a payment against the income tax liability of the non-insurance combined group. It is not at all clear that states have the capacity to administer this arrangement. If adopted, the draft proposed statute would require significant development of new administrative capacity in most states.

Notably, there has been no discussion in the Subcommittee regarding the administrative difficulties that would be created by the draft proposed statute. We respectfully request that the proposal be returned to the Subcommittee for further study.

3. The Subcommittee Has Not Considered the Effect of the Proposed Draft Statute on Insurance Companies and Their Policyholders.

As discussed in detail in the trades' July 22, 2010 letter, the draft proposed statute would have dramatic and unfair consequences for insurance companies and their policyholders nationwide, and those consequences have not been investigated or understood by the Subcommittee.

First, the draft proposed statute would impose tax on investments held by insurance companies in support of their obligations to pay policyholder claims. Imposing tax on the investment income of insurance companies would represent a fundamental shift in the long-standing nationwide system of state insurance taxes, which rests on the foundation of premium taxation, retaliatory taxation and constitutional and statutory "in lieu" protections, and has been the states' chosen system for taxing the privilege of conducting the insurance business nationwide.[8]

The underwriting and investment aspects of the insurance business are inextricably interrelated. As stated by the U.S. Supreme Court (in describing a life insurer's underwriting and investment receipts):

> An insurance company obtains most of its funds from premium paid to it by policyholders in exchange for the company's promise to pay future death claims and other benefits. The company is also obligated to maintain reserves, which, if they are to be adequate to pay future claims, must grow at a sufficient rate each year. The receipt of premiums necessarily entails the creation of reserves and additions to reserves from investment income. Thus the insurance company is not only permitted to invest, but it *must* invest; and it *must* return to the reserve a large portion of its investment income…

U.S. v. Atlas Life Insurance Co., 381 U.S. 233, 247 (1965). Although the premium tax component of the insurance tax system is based on gross underwriting receipts, this is a *comprehensive tax system on the privilege of engaging in an insurance business*, in all of its aspects, in the states. Thus, states have heretofore deemed the insurance tax system sufficient to tax the entire insurance business, i.e., its underwriting income (premiums) and its investment income.[9]

The inappropriateness of superimposing on this system a new tax on investment income is best illustrated by a simple example comparing a non-insurance corporate income taxpayer with an insurance company taxpayer. To make the example as objective as possible, it is based on the highly unlikely assumption that both taxpayers have the same amount of investment income. In reality, however, as a general rule, investment income would make up a much higher portion of the overall income of an insurance company than a non-insurance company, such that the proposal would result in a significantly higher tax burden on the insurance company than the non-insurance company.

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[8] Oregon is the only state that taxes insurers under a net income-based "excise" tax, but not a premium tax.

[9] Although some states supplement the premium tax with an income tax, insurers are generally permitted cross-tax credits or caps.

	Non-Insurance Co.	Insurance Co. current law	Insurance Co. after draft statute
Gross Receipts/Premiums	$1,000	$1,000	$1,000
Less: expenses	($950)	($950)	($950)
Investment income from pass-throughs[10]	$100	$100	$100
Net income before taxes	**$150**	**$150**	**$150**
Less: Taxes			
Income tax (7%)	$10.50	$0	$0
Income tax on pass-through entity (7%)	$0	$0	$7
Premium tax on gross premiums (2%)	$0	$20	$20
Total tax paid	**$10.50**	**$20**	**$27**

In this simple example, under existing law, an insurance company subject to 2% premium tax pays nearly 200% the amount of tax that a non-insurance company taxpayer subject to a 7% income tax with the exact same receipts and expenses would pay ($20 vs. $10.50). Subjecting the insurance company to the income tax on its investment income heightens the disparity, increasing the burden on the insurance company to nearly 260% ($27 vs. $10.50).

It is no solution to suggest that insurance companies could merely hold investment assets directly, rather than in partnership or limited liability company form, in order to avoid the application of this onerous and inequitable rule. Insurance companies hold investment assets in a variety of legal forms for legitimate and important business reasons,[11]

Although the undersigned trades have previously presented this issue to the Subcommittee, it does not appear that the Subcommittee has adequately evaluated the industry's concerns. We respectfully request that the proposal be returned to the Subcommittee with instructions to seek the perspective of state insurance regulators on this important issue.

4. The Draft Proposed Statute Is Based On the Faulty Premise That Insurance Companies Pay Less Tax Than Non-Insurance Businesses.

The draft proposed statute purports to be based on the notion that the current system results in an inequity, such that exempting insurance companies from the income tax somehow results in insurance companies bearing a lower tax burden than non-insurance corporate taxpayers. The purported purpose of the draft proposed statute is "to address an inequity in the income tax treatment of pass-through income generated by separate business entities that is entirely the result of the fact that some companies [*i.e.*, insurance companies] are not subject to state income tax."[12] The notion that the current system results in "inequity" that favors insurance companies is demonstrably incorrect, as illustrated by the example discussed above. The results

10 Example is for purposes of illustration and does not necessarily reflect the proportion of investment income that might be earned by an insurance company from a investment held in pass-through entities.

11 Furthermore, the draft proposed statute does not contemplate the complexities associated with many variable insurance products that result in investments made on behalf of policyholders within Separate Accounts held by insurers. In this situation, an insurer is more properly characterized as a custodian of the investment rather than the owner. The policyholder enjoys the economic benefits of the investment made by the Separate Account and thus would suffer the cost of any tax imposed on an investment held by a Separate Account.

12 Memo from Sheldon Laskin to the Subcommittee, dated June 11, 2010, fn 4.

of that example are confirmed by multiple studies conducted by states and economists over decades. It is universally accepted in the academic and economic communities – and recognized by the MTC itself[13] -- that the insurance tax system imposes a tax burden that is many multiples of the tax burden imposed on non-insurance corporate taxpayers, or that would be imposed on the insurance industry if it were subject to income taxation in lieu of the current insurance tax system.[14]

Professor Martin F. Grace concisely begins his study of the relative burden imposed by the state life insurance tax system (*Excessive State Taxation of the Life Insurance Industry: The Case for Reform* (December 23, 2003)) with the simple finding that "[t]he insurance industry is overtaxed."[15] Others who have compared the insurance and corporate income tax systems for states and/or industry agree. The following illustrative excerpts from various studies represent only a handful of examples of the relevant research (examples confined to member states of the Subcommittee in the interest of brevity, emphasis supplied):

- ***California (2008).*** "Economists who have examined state insurance taxes have found that a simple comparison of premiums to net income suggests that **insurance premiums tax revenues are several times higher than a profits tax** would produce…This is also true in California…" *Investment Income and the Insurance Gross Premiums Tax* (California Legislative Analyst's Office at page 4).

- ***California (2003).*** "All of the available evidence shows that California's tax laws currently impose a **much heavier burden on insurance companies** than on companies in other industries." *The Taxation of Insurance in California* (Hamm, Fortenbaugh, Schmidt, Johanson at LECG Economics and Finance at page iii).

- ***California (1991).*** "The income-based tax burden on these property/casualty insurers [companies writing between 42.3% and 50.1% of the total California market between 1984-1989] ranged from a low of 16.9% in 1987 to a high of 53.9% in 1985 and **exceeded the tax rates imposed on other industries in every year**." *California Taxation of the Property/Casualty Insurance Industry* (Hofflander, Nye, Charlesworth, Brydon at Stanford Consulting Group at page i).

- ***California (1990).*** "These figures illustrate that the **tax burden imposed on the life insurance industry** by the State of California **greatly exceeds that imposed on other California industries**." *Taxation of the California Life Insurance Industry* (Hofflander, Nye and Charlesworth at page 5).

- ***Florida (2006).*** "The insurance premium tax has grown in importance as a source of tax revenue in recent years as annual intangibles tax and estate tax revenues have been reduced to zero. **Because of its growing importance as a revenue source, proposals to change this tax warrant careful scrutiny**." *An Overview of Florida's Insurance*

[13] The March 6, 2009 and November 20, 2009 memos to the Subcommittee recognize that Minnesota repealed its income tax on insurers because the premium tax "consistently yielded much higher revenue."

[14] It also is well accepted that the insurance tax system generates a reliable, generally growing source of revenue for the states, far in excess of the revenue that would be generated by taxing insurer income, and that remains steady during periods of economic stress and reduced corporate profitability.

[15] It should be noted that Professor Grace is considered a credible source by MTC staff. *See* Memo from Sheldon Laskin to the Subcommittee, dated February 19, 2010.

Premium Tax, Report No. 2007-122 (Prepared by Committee on Finance and Tax for Florida Senate at page 17).

- ***Florida (1991).*** "The P&C industry was subject to an **effective tax rate of 33.5** percent in Florida over the five-year period from 1985 to 1989 (using the statutory income measure which is applied for the purpose of insurance regulation). The effective tax rates for the comparison industries in the manufacturing, retail trade and banking sectors ranged from 5.6 to 9.9 percent over the same period." *Comparative Analysis of the Taxation of the P&C Insurance Industry in Florida* (Price Waterhouse at page i).

- ***Florida (1990).*** "There is a wide acceptance and a statistical basis for determining that each one percent of the insurance premium tax (a gross receipts tax) is equivalent to a 20.4% net income tax." *Report of the Florida Insurance Premium Tax Task Force to the Florida Legislature* (at page 4).

- ***Massachusetts (1997).*** "Taxes as a percentage of profits are **higher in the insurance industry than in any other industry** in the state and greater than on other financial services." *The Effect of State Tax Policy on the Insurance Industry In Massachusetts* (Prof. Craig L. Moore, University of Massachusetts at page 7).

- ***Missouri (2003).*** "Banking and other credit institutions paid an average of only $8000 in 2002. Insurance companies, in comparison, paid an average of about $86,400 per company, **approximately 20 times the average liability of the non-financial corporations** and nearly eleven times the average liability of other financial institutions." *2003 Taxation of the Insurance Industry in Missouri* (Dr. Edward H. Robb at page 2).

- ***Missouri (1992).*** "As can be seen from the data…the insurance industry bears a vastly disproportionate tax burden. Nonfinancial corporations with positive net income paid net Missouri income taxes of $206.5 million in fiscal year 1991. This amounts to an average liability of approximately $7,100 per return. These corporations also paid $57.5 million in franchise taxes, an average of about $2,100 per corporation – a total of less than $10,000 from both taxes. Insurance companies, in comparison, paid $124.4 million, an average of about $74,000 per company, approximately **8 times the average liability of the nonfinancial corporations**." *Taxation of the Insurance Industry in Missouri* (Dr. Edward H. Robb at page 2).

- ***Texas (2004).*** "The premium tax and other state and local taxes impose a **significantly higher tax burden** on property/casualty insurers that the tax they would pay if taxed as general corporations. This study estimates the property/casualty insurers paid $334 million more in taxes in FY 2003 than they would have if they were taxed as general corporations." *Tax Burden Imposed on Property/Casualty Insurers in Texas* (Ernst & Young at page 1).

- ***Texas (2004).*** "Because the premium tax applies to a tax base much larger than the base for the franchise tax, the premium tax combined with other state and local taxes, imposes a **significantly higher tax on life/health insurers** than the tax they would pay if they were taxed as general corporations…[W]hile general corporations are subject to a maximum rate of 4.5 percent of net taxable earned surplus (net income), the premium taxes paid by life/health insurers are equivalent to 17.1 percent of net taxable earned surplus." *The Excess Taxation of Life/Health Insurers in Texas* (Ernst & Young at pages 1-2)

- ***Texas (1998).*** "Price Waterhouse studies prepared in 1991 and 1997 found that the effective tax rate imposed on the P&C industry in Texas was, on average, **4 to 8 times higher than for five other representative industry groups** in Texas over the 1985-1989 and 1992-1993 periods." *Taxation of the Texas Property and Casualty Insurance Industry* (Price Waterhouse at page E-1).

The academic and economic literature is compelling: the current system imposes a higher tax burden on insurance company taxpayers than non-insurance company taxpayers. This burden is imposed on the privilege of engaging in the insurance business – including both underwriting and investing – in a state. The premise of the draft proposed statute, therefore, is false. There is no "inequity" in the current insurance tax scheme that favors insurance companies.

Although the undersigned trades have previously presented this issue to the Subcommittee, it does not appear that the Subcommittee shares the industry's view regarding the inequities of imposing an additional tax on the insurance business. We respectfully request that the proposal be returned to the Subcommittee with instructions to seek the perspective of state insurance regulators on this important issue.

5. The Draft Proposed Statute Discriminates, Creating New Inequities.

Enactment of the draft proposed statute would create substantial inequities where none currently exist, because the draft proposed statute discriminates against pass-through entities owned by entities that are not subject to an income tax (e.g. insurance companies) in favor of pass-through entities owned by companies that are subject to an income tax. The inequities that would be created by the draft proposed statute have not been included within the written analysis prepared to date, have not been considered by the Subcommittee, and are fundamentally unfair. Specifically:

First, the draft proposed statute discriminates against insurance companies in favor of non-insurance corporate income taxpayers because non-insurance corporate income taxpayers are permitted to use losses in pass-through entities to offset their income or income earned by other pass-through entities in computing the amount of income tax due. Under the draft statute, if a pass-through entity has income, the income would be taxed at the pass-through level to the extent the entity is owned by an insurance company, regardless of whether the insurance company also owns other pass-through entities that have experienced losses. A non-insurance corporate income taxpayer, on the other hand, would be able to offset the pass-through entity's income using either losses earned by other pass-through entities or using its own losses.

Second, the draft statute discriminates against insurance companies because any losses in an insurance company could not be used to offset income earned by the pass-through. A non-insurance corporate income taxpayer, on the other hand, would be able to offset its losses against the pass-through entity's income. Thus, an otherwise unprofitable insurance company would in essence face two different state tax liabilities (i.e., premium and retaliatory tax and a reduction in the pass-through entity's income because of the income tax at the pass-through entity level under the draft statute) and an unprofitable non-insurance corporate income taxpayer would not owe tax at all. The example below illustrates this point using a non-insurance corporate taxpayer with $1,000 of gross receipts, $1,100 of expenses, and $100 of investment income earned through a pass-through entity. The non-insurance corporate taxpayer uses the investment income to offset operating losses, and pays $0 of overall tax. An insurance company with the exact same items, on the other hand, pays $27 of total tax.

Because the pass-through entity's income cannot be offset by an insurer's losses (whether investment or underwriting), even an unprofitable insurance company would bear the economic burden of gross receipts taxes on its premiums (under the existing premium tax statute) and a new tax imposed on the gross amount of its investment income (under the draft statute). The non-insurance corporate income taxpayer, however, is only subject tax on net profits, and if profits are $0, the amount of tax imposed is $0.

	Non-Insurance Co.	**Insurance Co. after draft statute**
Gross Receipts/Premiums	$1,000	$1,000
Less: expenses	($1,100)	($1,100)
Investment income from pass-throughs	$100	$100
Net income before taxes	**($0)**	**($0)**
Less: Taxes		
Income tax (7%)	$0	$0
Income tax on pass-through entity (7%)	$0	$7
Premium tax on gross premiums (2%)	$0	$20
Total tax paid	**$0**	**$27**

Third, the draft proposed statute discriminates among insurance companies based on the manner in which they choose to hold investments. Under current law, an insurance company is taxed by most states in the same manner regardless whether it owns an investment directly or indirectly (*i.e.,* through an ownership interest in a pass-through entity). As described below, decisions regarding how investments of insurance companies should be held are highly sensitive to state regulation of financial investments, and state regulatory laws create incentives to encourage outcomes in the interest of protecting policyholders. State income tax law should not drive business decisions regarding the form of an investment. The draft statute, however, would discriminate against insurers holding investment in pass-through or limited liability form, creating an incentive, for example, for an insurance company to invest in less than a controlling share of any pass-through entity. In creating these incentives, the Subcommittee has not coordinated with the NAIC or state insurance regulators.

Fourth, it appears to be intended that the draft statute would not be adopted by a state that subjects all insurance companies to income taxation. However, it is not clear how the draft proposed statute would be applied in states that (a) only subject certain insurers (*e.g.,* domestic companies) to income tax (*e.g.,* Arkansas, Indiana, Wisconsin), (b) apply reciprocal income tax non-retaliation (*e.g.,* Illinois, Nebraska), (c) provide that income tax is creditable (in whole or part) against premium tax (*e.g.,* Florida, Illinois, Mississippi, Nebraska),(d) provide that premium tax is creditable (in whole or part) against income tax (*e.g.,* Louisiana, New Hampshire), (e) apply caps to combined income and premium tax liability (*e.g.*, Illinois, Nebraska, New York), or (f) impose income tax on bases that are, in whole or part, gross (*e.g.*, Indiana, New Hampshire). Depending on how these issues are addressed, the existing inequities identified above could be aggravated.

Although the undersigned trades have previously presented these concerns to the Subcommittee, it does not appear that the Subcommittee has considered them in any detail. We respectfully request that the proposal be returned to the Subcommittee with instructions to seek the perspective of state insurance regulators and recognized tax policy experts (such as Professor Pomp) on these concerns.

6. Any concern among Subcommittee members regarding "abusive" transactions is ill-founded. Insurance companies are subject to extensive state regulation that requires investment decisions to be driven by nontax business considerations. States already possess ample tools to combat transactions perceived as abusive.

The primary goal of state regulation of insurance companies is the protection of policyholders. To ensure that an insurance company will have sufficient funds to cover policyholder claims, states exercise stringent financial oversight of insurance companies. Although the purpose of this system of regulation is to protect policyholders, the system operates to prevent insurance companies from engaging in the type of abusive, tax-motivated transactions about which members of the Subcommittee have previously expressed concern in at least the three ways described below.

First, state insurance regulators review the financial aspects of insurance companies on a regular basis, at least quarterly. The rules for financial regulation of insurance companies are promulgated by the National Association of Insurance Commissioners. States must use these rules to maintain their accredited status.

Second, states regulate the investments of insurance companies by applying an investment law with a variety of restrictions (either the NAIC Defined Limits Version or the Defined Standards Version. Under the Defined Limits Version an insurance company may invest only in those investments permitted by statute and only in limited percentages. Under the Defined Standards Version, the capital and surplus of an insurance company and a certain percentage of reserve liabilities must be invested in very conservative investments, and the state applies a "prudent person" approach to investments in excess of a certain threshold. States commonly regulate the investments of insurers in affiliates other companies and subsidiaries, limiting the amount an insurance company may invest in subsidiaries to 10% of the amount of the company's "admitted assets" (*i.e.*, assets that are counted in determining the solvency of the company). Insurance commissioners may enjoin companies from making investments that would violate these restrictions, and insurance companies that violate the restrictions are subject to various penalties, including fines. Thus, because an investment in a controlled affiliate is subject to limits driven by state insurance regulation, it is generally true that the decision whether to make such an investment is driven by nontax, business considerations. .

Third, insurance companies are subject to both fixed minimum capital requirements and so-called "risk-based capital" or "RBC" requirements that operate to discourage companies from holding assets in affiliated entities. RBC requirements are determined through the application of formulas developed by the NAIC that apply various modeling, correlation and discount factors to compare the value of the actual capital held by an insurance company (called "total adjusted capital" or "TAC") to its RBC. When the ratio of TAC to RBC reaches a certain threshold level, state regulatory law permits the insurance regulatory agency to take action ranging from permissive intervention to assuming control of the company. RBC ratios are also relied on extensively by market participants (investors, lenders, rating agencies) as a measure of the financial strength of an insurance company.

In computing an insurance company's RBC ratio, different assets held by the insurance company are included at anywhere from 100% to 30% of their value. For example, debt rated A/a or better is subject to a 0.4% haircut, whereas debt rated B/B is subject to a 10% haircut. By contrast, investments in partnerships and LLCs are subject to a 19.5% haircut. These discounts create a strong disincentive for insurance companies to invest in any assets other than highly-rated debt instruments, because of the high discount associated with such investments in the RBC calculation. Because investments other than highly-rated marketable debt are disfavored by the state insurance regulatory scheme, it is generally true that the decision whether to make such an investment is driven by nontax, business considerations.

Finally, members of the Subcommittee have previously expressed concern that certain businesses previously subject to income tax were "restructured" to "shift income" from a corporate income taxpayer into an insurance company exempt from corporate income tax. This concern is ill-founded, again because the state insurance regulatory system creates a strong disincentive to hold assets in an insurance company other than those needed to cover policyholder liabilities. Specifically, state insurance regulatory laws impose restrictions on the ability of an insurance company to pay dividends. Dividends are permitted only up to a certain percentage of surplus, and are only permitted with regulatory approval. Because of this restriction, the decision whether to hold an investment in an insurance company or an affiliate is driven by nontax business considerations.

Although the undersigned trades have previously presented this points to the Subcommittee, it does not appear that the Subcommittee has further investigated the nature of insurance company investments or the regulation of insurance company investments. We respectfully request that the proposal be returned to the Subcommittee with instructions to seek the input of state insurance regulators on this important issue.

Conclusion

The undersigned trades urge the MTC to return this project to the Subcommittee for further evaluation and consideration, with specific instructions to consult with state insurance regulators on the points raised in these comments. We appreciate the opportunity to present these comments and look forward to discussing them with you.

Respectfully submitted,

AMERICAN COUNCIL OF LIFE INSURERS
AMERICAN INSURANCE ASSOCIATION
PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

cc: Joe Huddleston, Executive Director
Shirley Sicilian, General Counsel
Sheldon Laskin, Counsel

Non-Income Taxpayer Project Cover Letter Of March 29, 2012

Sheldon/Shirley - This correspondence is submitted on behalf of the American Council of Life Insurers, the American Insurance Association and the Property Casualty Insurers Association of America. ('the Trades"). The submission specifically deals with four aspects of the current Non-Income Taxpayer Project as outlined and discussed below.

1) It reiterates the insurance industry's strong belief that if this project is even necessary, the potential abusive use of an insurance company to evade taxes should be its focus. From the outset of this project the industry has made it clear that we believe the tax treatment of LLCs and partnerships owned by insurance companies cannot be separated from the rationale for and truly unique nature of the premium/retaliatory tax system imposed on the insurance industry. When viewed holistically as it should be, the insurance industry reasserts there is no issue of equity.

2) It provides feedback on an important aspect of the Executive Committee's discussion at last July's annual meeting that focused on whether tools already exist that can be used or enacted by states to address overcapitalized insurance companies/abuses.

3) As requested by the Executive Committee at the annual meeting last July, it provides revised draft model language aimed at addressing the potential abusive use of an insurance company to evade taxes.

4) It responds to the Uniformity Committee's February 10 request for additional analysis of potential retaliatory tax implications as a result of the project's current model language.

Project Focus

During the last several Uniformity Committee calls, it became clear that a difference of opinion exists as to the focus of this project. The Uniformity Committee seems to feel the project should deal strictly with the question of equity. Or to put it another way, that the treatment under the corporate income tax system of the income of certain LLCs and partnerships in which an insurance company invests must somehow be the same as afforded a non-insurance company investor, notwithstanding that the insurance company is subject to a distinct state tax system.

However, the Trades have opined that the focus should be, not on this so-called "tax equity" issue, but rather on the potential abusive use of an insurance company to evade taxes. The Trades' position on these issues has been set forth in detail in its prior submissions. This submission, which responds to a specific request from the Uniformity Committee, is intended to supplement (but not supersede) these prior submissions.

The "Tax Equity" document and three (3) previously submitted documents ("May 16, 2011", "July 22, 2010" and "February 19, 2010") attached to this note provide detailed support for our position on this matter.

Existing Tools

Perhaps the threshold question, as was raised during the last July's Executive Committee meeting, is whether sufficient tools already exist for states to effectively deal with any true tax abuses involving insurance companies, including the Uniformity Committee's misperceived matter of tax inequity. While we appreciate the MTC and the states are in a better position to address that question, the Trades believe the states have sufficient tools to address such abuses, so that this project is not necessary .

The "Existing Tools" document attached to this note provides an overview of various tools that are currently available to states.

Revised Draft Model Language

If the Executive Committee decides to move forward with any model, the Trades believe the revised draft "Model Language" document attached to this note includes language that could be used – in a focused and targeted manner – to complement current law authorities.

Retaliatory Tax Analysis

The Trades have consistently indicated that the MTC's current version of the non-income taxpayer model language would carry real and substantial risks of triggering state retaliatory taxation. This concern has been echoed in all of the expert, third party input received by the MTC, including Professor Richard Pomp, representatives of the insurance regulatory community representing both the National Association of Insurance Commissioners (NAIC) and the Pennsylvania Insurance Department, and the Trades themselves.

The "Retaliatory Taxes" document supplements the industry's prior submissions on these retaliatory tax concerns. In addition, the "NAIC Survey" document provides a 50 state overview of retaliatory tax laws which was assembled for the Uniformity Committee by the NAIC. Both of these documents are also attached to this note.

Conclusion

We believe this submission coupled with prior submissions address the questions posed and responds to the requests made by the MTC staff, Uniformity Committee and the Executive Committee to date. We also strongly believe tax equity is not at issue here. Instead, if a new model bill is needed at all, the focus should on any abusive use of an insurance company.

Thank you and your team again for the time and effort devoted to this matter. And please feel free to contact us with any additional questions.

“Tax Equity”

Attached as part of this submission are copies of several of the Trades’ prior filings with the MTC, addressing the “tax equity” concern that is the Uniformity Subcommittee’s sole stated rationale for its model bill. We call to your attention, in particular, the following discussions of this issue:

- Filing dated May 16, 2011 (pages 6-11)
- Filing dated July 22, 2010 (pages 4-8)
- Filing dated February 19, 2010 (page 2)

Existing Tools to Address MTC Concerns
Relating to Certain Income Tax Abuses/Inequities

1) Roughly 50% of the states have authority to require combined reports for unitary groups. Depending on the state, this authority may allow for inclusion of an insurance company in a combined report with its non-insurance company affiliates.

2) Section 2.B of MTC's Combined Report Model (approved on August 17, 2006) allows for the inclusion of insurance companies in a combined report with their non-insurance company affiliates in certain instances.

3) Roughly ten (10) states subject the insurance company to income tax in addition to premium tax. Generally, those states allow credits for the income taxes against the insurer's premium taxes. In these situations, the insurer is subject to corporate income taxation on the income of a pass-through entity in which it invests.

4) Most states, whether requiring separate company or combined reporting, have statutes, regulations or both that provide the Director or Commissioner of Taxation broad discretionary authority to make a range of adjustments to properly reflect tax when a company has arranged or conducts its business in a manner for which the primary purpose is tax evasion.

5) California law requires a reduction or disallowance of a deduction for dividends received from an overcapitalized insurance company.

6) Judicial doctrines such as sham transaction, economic substance or business purpose may be available to states to challenge tax evasion involving any misuse of insurance companies for state income tax purposes.

Model Language

(a) When more than 50 per cent of the capital interests or profits interest in an entity for which deductions would be allowed under section 162 of the Internal Revenue Code, 26 U.S.C. 162 and that would otherwise be treated as a partnership or disregarded entity for purposes of the corporate tax law is owned directly by a disqualified insurance company as defined in subpart (b), the partnership or disregarded entity shall be taxed as if the partnership or disregarded entity were a corporation subject to tax under chapter [*insert state statute]* to the extent of the distributive share of the disqualified insurance company. To the extent applicable, income that is taxable to the partnership or disregarded entity pursuant to this section, and any related tax attributes and activities, shall be included and taken into account in a combined report filed under [*insert state statute*].

(b) For purposes of this section only, a disqualified insurance company is defined to mean

i. An entity that does not qualify for treatment as a life insurance company as defined in section 816 of the Internal Revenue Code of 1986 or as an insurance company as defined in section 831(c) of the Internal Revenue Code, or

ii. An entity that would not qualify for treatment as a life insurance company as defined in section 816 of the Internal Revenue Code of 1986 or as an insurance company as defined in section 831(c) of the Internal Revenue Code if that entity was deemed to directly own assets that it actually owns indirectly though its 50% or more investment in a partnership or disregarded entity, or

iii. An entity where the investment in the partnership or disregarded entity is not an admitted asset on the insurance company's books as defined by the National Association of Insurance Commissioners ("NAIC").

RETALIATORY TAX RISKS UNDER THE MTC MODEL

If the MTC adopts the Model,[1] which then is enacted by State M, there is a real and substantial risk that this new tax burden imposed by State M would trigger retaliatory taxation of State M's insurers doing business in other states. In this event, the Trades might wish to preserve their ability to argue vigorously in opposition to this practice. Thus, while the Trades could anticipate and describe the arguments a state could make to support its retaliation against the tax imposed by the Model (based on members' experiences over many years with state retaliation against a broad range of burdens), we are loathe to do so. However, what we can state at this time is that the conclusion of some in the MTC that there could be no retaliation against the Model is unfounded, inconsistent with *all outside input* received by the MTC on this question to date, and difficult to square with certain fundamentals of the retaliatory tax system.

Background: History of Retaliatory Taxation

In *Western & Southern Life Ins. Co. v. State Bd. of Equalization,* 451 U.S. 648 (1981), the U.S. Supreme Court upheld California's retaliatory tax statute against a challenge under the Equal Protection Clause. In this case, the Court observed that retaliatory tax laws are a fact of life in the existence of any insurance company that does business on a national level. Although retaliatory taxes may incidentally produce revenue, the primary purpose of these laws is to compel the foreign state imposing greater costs to lower the "premium or income or other taxes, ... fees, fines, penalties, licenses, deposit requirements or other obligations," or to remove any "prohibitions or restrictions ... imposed upon" the insurance companies of the domiciliary state. *Id.* At 668-670. Thus, when a state enacts legislation subjecting insurers to a burden that triggers retaliation by other states, the enacting state creates a tax disincentive to the jobs and investment provided by a robust domestic insurance industry, and to its insurers seeking market share in other states.

Insurance retaliatory taxes, in existence since the 19th Century and unique to the insurance tax system, were aptly described in an early decision of the Kansas Supreme Court, as follows:

> Now, our insurance laws provide that insurance corporations of other states may enter into this state and transact business upon certain limited conditions, designed only to protect the citizens of this state against irresponsible and fraudulent organizations elsewhere. In other words, this state holds itself out to all other states of the Union as willing to meet them upon a basis of substantial freedom as to all insurance transactions. It couples, however, with this general extension of freedom, a provision that if any other state shall, by its laws, hamper and restrict the privileges of corporations created under our laws, in the transaction of insurance business within its borders, the same burdens and restrictions shall be imposed upon corporations of that state seeking to transact business with us. This provision is called in insurance circles a 'retaliatory clause.' It seems to us more justly to be deemed a provision for reciprocity. It says, in effect, that while we welcome all insurance corporations of other states to the transaction of business within our limits, we insist upon a

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[1] As used herein, "the Model" refers to the MTC's model bill relating to disregarded entities in its current form, "State M" refers to a state that is the insurer's domiciliary state that that enacts the Model, and "State R" refers to a retaliating state, which also is the insurer's market state .

> like welcome elsewhere, and that if other states shall attempt, directly or indirectly, to debar our corporations from the transaction of insurance business within their borders, we shall meet their corporations with the same restrictions and disability.

Phoenix Ins. Co. v. Welch, 29 Kan. 672 (1883).

Forty-nine states and the District of Columbia currently impose retaliatory taxes. Generally, retaliatory tax statues are broadly drafted so as to satisfy their overall purpose of deterring foreign states from imposing higher taxes, fees or obligations on the enacting state's domestic industry.

Attached is a 50-state survey, provided by the NAIC, of the state retaliatory laws imposed nationwide. We are not aware that the MTC has done any analysis of this survey. However, even a cursory review reflects that most retaliatory tax statutes use broad terms to define what is included and narrow terms to define what is excluded. For example, Alabama's retaliatory tax statute (at issue in *Western & Southern*) provides as follows**:**

> (a) The purpose of this section is to aid in the protection of insurers formed under the laws of Alabama and transacting insurance in other states or countries against discriminatory or onerous requirements under the laws of such states or countries or the administration thereof.
>
> (b) When by or pursuant to the laws of any other state or foreign country, any taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements or other material obligations, prohibitions or restrictions are, or would be, imposed upon Alabama insurers, or upon the agents or representatives of such insurers, which are in excess of such taxes, licenses and other fees, in the aggregate, or which are in excess of the fines, penalties, deposit requirements or other obligations, prohibitions or restrictions directly imposed upon similar insurers, or upon the agents or representatives of such insurers, of such other state or country under the statutes of this state, so long as such laws of such other state or country continue in force or are so applied, the same taxes, licenses and other fees, in the aggregate, or fines, penalties or deposit requirements or other material obligations, prohibitions or restrictions, of whatever kind, shall be imposed by the commissioner upon the insurers, or upon the agents or representatives of such insurers, of such other state or country doing business or seeking to do business in Alabama. Any tax, license or other fee or other obligation imposed by any city, county or other political subdivision or agency of such other state or country on Alabama insurers, or their agents or representatives, shall be deemed to be imposed by such state or country within the meaning of this section.
>
> (c) This section shall not apply as to personal income taxes, nor as to ad valorem taxes on real or personal property nor as to special purpose obligations or assessments imposed by another state in connection with particular kinds of insurance, other than property insurance; except, that deductions from premium taxes or other taxes otherwise payable allowed on account of real estate or personal property taxes paid shall be taken into consideration by the commissioner in determining the propriety and extent of retaliatory action under this section.
> Code of Alabama, §27-3-29.

This statute takes into account any taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements or other material obligations. It applies to insurers and their agents or representatives. The Alabama statute explicitly excludes only ad valorem taxes, personal income tax and certain special purpose assessments. The express, codified purpose of this statute is to protect Alabama's insurers against "discriminatory or onerous requirements under the laws" of other states in which they are doing business.

It is the nature of retaliatory taxation that whether this tax would be triggered by the Model would depend, not on the state enacting the Model, but rather on all of the other states in which insurers based in the enacting states write business. Further, states adopting the Model would have little or no influence over the way retaliating states apply their retaliatory tax statutes. It also is in the nature of retaliatory taxation that retaliatory practices tend to cascade through the nationwide insurance tax system. Thus, states are prone to amend their tax, assessment, and regulatory statutes (including retaliatory tax statutes) to respond to unconventional retaliatory tax practices, harmful to the amending state's insurers, adopted by other states. The amended statute then applies to all insurers doing business in that state, regardless where these insurers are domiciled. In short, retaliatory taxation tends to beget retaliatory taxation, so that if even a single state adopts the Model and a single state retaliates against it, the tax effects will not be confined to these two states, but will tend to ripple through other states as well.

<u>Outside Input Received by the MTC</u>

The insurance regulatory community has provided the MTC with input on the retaliatory tax implications of the Model. At meetings of the Uniformity Subcommittee's working group, the highly-respected Deputy Commissioner of Pennsylvania's Insurance Department (Steve Johnson) and counsel for the NAIC (Dan Schelp), both speaking on behalf of the NAIC at the MTC's invitation, opined (to the best of our recollection) that the Model could have adverse retaliatory tax consequences for insurers (with Deputy Commissioner Johnson characterizing this as a "huge" issue about which he would be "very concerned"). Other outside commentators on this issue have been in accord with this conclusion:

> *To the best of the Trades' knowledge, the Subcommittee has not conducted a comprehensive review of the threat of retaliatory taxation. As we have previously commented, the Trades have serious concerns that the threat of retaliatory taxation is very real. The draft Statutes rely on a fiction for the purpose of avoiding insurance retaliatory taxes. This fiction – that a pass-through entity is a taxable entity—applies only when the pass-through entity is by limited and defined entities including insurance companies. By singling-out insurance companies, the Draft Statues invite retaliation by the states.* [The Trades submission to the MTC (July 22, 2010)]
>
> *The workings of the retaliatory tax are not always fully appreciated outside the cognoscenti [footnote omitted]…Yet understanding it is critical to evaluating any proposal to change the status quo…Without appreciating the interaction between retaliatory tax and changes in existing tax rules, the best of intentions may well backfire…Any proposal…that singles out the income taxation of pass-through entities based on whether they are owned by insurance companies raises an issue of how the retaliatory tax will be applied…The law of unintended consequences should caution*

> *against any rush to judgment.* [Professor Richard D. Pomp's submission to the MTC (March 3, 2010)]
>
> *While it was retaliatory tax risks that first caused Massachusetts to refer this project to the MTC, the Staff Analysis fails to take account of any empirical evidence relating to these risks (or even of diverse state retaliatory tax statutes and practices) Instead. The Draft Statute seeks to avoid these risks by creating a fiction; that a pass-through entity is not a pass-through entity if it's owned by an investor that is an insurance company. But the Staff Analysis fails to consider why other states should respect this fiction when it is created by an insurer's home state for the sole and express purpose of avoiding retaliatory taxes (a substantial source of revenue for lower-tax states) in these other states. And beyond the risk of states retaliating, the Staff Analysis fails to consider the implications for the state insurance tax system (and the states) if states do retaliate against the Draft Statute.* [The Trades submission to the MTC (February 19, 2010)]

The Trades are aware of no outside input received by the MTC that contradicts this conclusion that adoption of the Model would pose a real and substantial threat of retaliation.

<u>MTC's "No Retaliation" Rationale</u>

Those in the MTC who conclude that the Model would not trigger a state's retaliatory tax, have relied solely on the following (apparently related) conclusions:

- Since the Model imposes tax directly on the pass-through entity rather than the insurer/investor, retaliating states could not view this tax as an insurer burden under their retaliatory tax statutes.

- Since income taxes imposed on insurer investments in corporations have not historically triggered retaliatory taxes, neither would income taxes imposed by the Model on insurer investments in LLCs, partnerships, and other disregarded entities.

As to the first conclusion, although the Model imposes tax on the pass-through entity and not on the insurer in form, it is clear that the Model is designed to tax insurer investment income in substance. The history of the Model (initially referred to the MTC by Massachusetts' Revenue Commissioner) reflects that when Massachusetts first proposed to tax the income earned by insurance company investments in pass-through entities, the tax was imposed directly upon insurers. When retaliatory tax concerns were raised, the response was to modify the proposal to impose the tax on the pass-through entity rather than the insurer. Thus, imposition of the tax under the Model was shifted from the insurer to the pass-through entity solely for the purpose of avoiding retaliatory taxation.

With the MTC and the NAIC now actively engaged in this project, it would be unlikely to escape the attention of insurance tax regulators that the history of the Massachusetts' proposal and the Model reflect that these proposals are aimed at investors that are insurance companies. We have seen no MTC response to the question raised in our prior testimony (excerpted above), as to whether (or why) the MTC expects that State R would respect a tax fiction adopted by State M solely and expressly for the purpose of avoiding State R's retaliatory tax statute.

Moreover, the MTC's stated tax equity rationale for the Model puts the focus on the absence of corporate income tax collected on this investment income at the level of the insurance company, not the disregarded entity. The fact that this investment income is not subject to tax at the level of the insurance company investor (because it pays a gross premiums tax in lieu of an income tax), but would be subject to tax at the level of another corporate investor (because it pays income tax, but not a gross premiums tax) is the *sine qua non* of the Model. Thus, the Model is premised on taxation, not of the pass-through entity, but of the insurance company. It seems likely that this would be a persuasive consideration in a state's decision to retaliate.

And as for the second conclusion, it is true that there is no retaliation today against income tax imposed on non-insurance corporations in which insurers invest. This is because the taxation of corporate income is a basic and uniform principle of the state (and federal) income tax system. It is the effect of insurance retaliatory taxation to level insurance tax imbalances among states. Since most all states will tax the income of such corporate entities, there is no fundamental imbalance here between State R and State M that would be likely to prompt the invocation of retaliatory taxation.

It also is a basic principle of the income tax system that the income of a "disregarded entity" is disregarded at the entity level. Taxing this income to the otherwise-disregarded entity constitutes a deviation from income tax norms. When State R sees its home state insurers taxed by State M in a manner that deviates from the norms of the corporate income tax system (by taxing partnerships, LLCs, and other otherwise-disregarded entities), as well as the insurance tax system (by taxing investment income), there is no reason to expect that State R will refrain from treating insurers from State M – under the authority of its retaliatory tax – in a like manner. And here again, the nature of retaliation means that these tax effects, once set in motion, are not likely to remain confined to two states.

Lastly, it bears noting that in states that already apply income taxes to insurance companies (e.g., Illinois), the income from single-member LLCs already is subject to income tax and that this income tax is retaliated against by other states.

Conclusion

All outside experts consulted by the MTC are in accord that a state's adoption of the Model would carry a real and substantial risk of triggering insurance retaliatory taxation. Some in the MTC disagree.

The MTC should conduct a fair and expeditious survey of state regulators who administer insurance retaliatory taxes to ask if there is a risk that the model, if adopted by a state, would be retaliated against. The results of this survey would replace unfounded speculation with empirical evidence based on the responses of state insurance and tax regulators – all now at the table on this project -- about retaliatory tax risks under the Model, bringing clarity to the MTC's unresolved questions in this area.

State Survey on Retaliatory Taxes

Alabama

§ 27-3-29

When taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements, etc. charged Alabama insurers would exceed those imposed by Alabama on similar insurers, a retaliatory tax will be imposed. Taxes imposed by political subdivisions are considered imposed by the state. All fees and taxes are aggregated on a separate retaliatory tax form, PG.

Alaska

§ 21.09.270

If taxes, licenses and fees in the aggregate and fines, penalties, deposit requirements, etc. imposed on Alaska insurers or representatives is in excess of charges Alaska makes on similar insurers or representatives, a retaliatory fee will be imposed. Does not apply to personal income taxes or to ad valorem taxes on property or to special purpose assessments imposed in connection with other than property insurance, except that deductions from premium taxes or other taxes otherwise payable allowed on accounts of real estate or personal property taxes paid shall be taken into consideration. A health care insurer may not include taxes, assessments, or other similar obligations on health care insurance premiums received from the state, a municipality, a city or borough school district, a regional educational attendance area, the University of Alaska or a community college operated by the University of Alaska.

Arizona

§ 20-230

When by or pursuant to the laws of any other state any premium or income or other taxes, or any fees, fines, penalties, licenses, deposit requirements or other material obligations are, in the aggregate, in excess of those Arizona applies to similar insurers domiciled in other states, a retaliatory amount is due. Any tax, license or other obligation imposed by any city, county or other political subdivision is deemed to be imposed by the state. Does not apply to ad valorem, taxes on real or personal property, or personal income taxes or to assessments on or credits to insurers for the payment of claims of policyholders of insolvent insurers. Arizona Administrative Code R20-6-205 prescribes the method and administration of the addition to the rate of tax for calculation of the burden of any tax, license or other obligation imposed by any city, county or other political subdivision of a state or foreign country on Arizona insurers on an aggregate statewide or countrywide basis.

Arkansas

§ 23-63-102

> The same taxes, licenses, and other fees, in the aggregate, and the same fines, penalties, deposit requirements or other material requirements, obligation, prohibitions, or restrictions that are imposed upon an Arkansas insurer by another state, will be imposed as a retaliatory tax or fee upon insurers of that state. Pursuant to Act 1965 of 2005, this section no longer applies to application fees, examination fees, license fees, appointment fees and continuation fees for agents and producers, adjusters, services representatives or consultants, or to personal income taxes, ad valorem taxes on real or personal property or to special purpose obligations, fees or assessments imposed by the other state in connection with particular kinds of insurance other than on property insurance. Deductions from premium taxes or other taxes allowed because of real or personal property taxes paid will be considered in determining the extent of retaliatory action under this section. This section shall not apply to any foreign insurer if more than 15% of its capital stock is owned by a corporation organized under the laws of this state and domiciled within this state.

California

California Constitution Article XIII, Section 28(f)(3), I.C. §§ 685, 685.1

> If any taxes, licenses and fees, in the aggregate, and any fines, penalties, deposits and other material obligations imposed on California insurers, and their representatives are in excess of the amounts charged similar insurers and their representatives by California, a retaliatory tax shall be imposed. Law does not apply to ad valorem taxes imposed by another state or country, unless allowed as a deduction from premium taxes due.

Colorado

§ 10-3-209

> If any taxes and fees in the aggregate, fines, penalties, deposits or other obligations imposed on Colorado insurers exceed those Colorado imposes on a similar insurer organized under the laws of another state, a retaliatory tax will result.

Connecticut

§ 12-211

> If the premium or income or other taxes or any fees, fines, penalties, claims or deposits imposed on Connecticut insurers are in excess of those Connecticut charges foreign insurers, figured on an aggregate state-wide basis, retaliation will occur. Any tax obligation imposed by a city, county or other political subdivision will be deemed to be imposed by the state. This does not apply to guaranty fund assessments except where another state imposes upon Connecticut insurers retaliatory charges for these assessments.

Delaware

tit. 18 § 532

If any taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements, etc. imposed on Delaware insurers or agents are in excess of those Delaware imposes on similar insurers, a retaliatory tax will be imposed. Shall not apply to personal income tax or to ad valorem taxes on real or personal property or to special purpose obligations or assessments imposed by another state in connection with insurance other than property insurance.

District of Columbia

§ 47-2610

When a state charges District of Columbia domiciled companies aggregate taxes which exceed the aggregate taxes that the District charges similar companies, retaliation occurs. When a state charges fines, deposits and other obligations in excess of those the District charges foreign insurers, retaliation may occur. This does not apply to personal income taxes, ad valorem taxes on real or personal property, and any special assessments charged by a state in connection with insurance other than property insurance. The District of Columbia does not include fees in the retaliatory tax computation

Florida

§ 624.5091, Rule. 12B-8.016

When another state charges taxes, licenses and fees in the aggregate, and any fines, penalties, deposit requirements, etc., to Florida insurers and agents that exceed the taxes, licenses, and fees, in the aggregate, or fines, penalties, deposit requirements that Florida imposes on similar insurers or agents, retaliation will occur. Any tax or license fee imposed by a city, county or other jurisdiction shall be deemed imposed by the state. A "similar insurer," is an insurer with identical premiums, personnel and property to that of the foreign insurer. This section does not apply to personal income taxes, nor to sales or use taxes, nor to ad valorem taxes on real or personal property, nor as to reimbursement premiums paid to the Florida Hurricane Catastrophe Fund, nor as to emergency assessments paid to the Florida Hurricane Catastrophe Fund, nor to special purpose assessments in connection with types of insurance other than property insurance.

Rule 12B-8.016

The State Fire Marshal regulatory assessment, the State Fire Marshal college surcharge and the Florida Insurance Guarantee Association assessment that was imposed upon the insurer's property insurance policies shall be included in the retaliatory calculations. If the state of domicile imposes a comparable assessment on a similar Florida insurer, the foreign or alien insurer must include that portion of the state of domicile's assessment that would relate to the similar insurer's property insurance premiums.

Georgia

§ 33-8-2

Fees or taxes imposed on Georgia agents and brokers subject to retaliation.

§ 33-3-26

When another state charges taxes, licenses and other fees in the aggregate and any fines, penalties, deposit requirements or other obligations upon Georgia insurers or their representatives which are in excess of those Georgia charges similar insurers or their representatives, retaliation will occur. Any tax imposed by a political subdivision will be deemed imposed by the state.

Hawaii

Hawaii does not impose retaliatory taxes.

Idaho

§ 41-340

When any taxes in the aggregate assessed against Idaho insurers are greater than Idaho would assess against similar insurers, retaliation will occur. Any taxes assessed by political subdivisions are considered assessed by the state. This shall not apply to personal income taxes, ad valorem taxes on real or personal property nor to special use assessments imposed on particular kinds of insurance other than property insurance. When an obligation is imposed on Idaho insurers or their producers in excess of obligations imposed on similar insurers or producers of another state or country, the same obligation will be imposed on insurers or producers seeking to do business in Idaho. "Obligation" includes license, fee, fine, penalty, deposit requirement, prohibition or restriction.

§ 41-288

If any state imposes a sanction, fine, penalty, or deposit requirement on any Idaho-domiciled insurer because of failure of Idaho to receive or maintain accreditation, the Idaho director shall impose the same requirement on insurers domiciled in that state.

Illinois

215 ILCS 5/444, Reg. 2515.10 to 2515.100

Any taxes, licenses or other fees in the aggregate, or any fines, penalties, deposit requirements as would be imposed on Illinois insurers as a condition precedent to their doing business in other states that would exceed those Illinois imposes on insurers, agents or representatives of insurers domiciled in other states, shall result in a retaliatory tax. This tax shall not apply to residual market or special purpose assessments or guaranty fund or guaranty association assessments under the laws of this state and under the laws of any other state or country.

The taxes, licenses or other fees for the Illinois basis includes only those found in Article XXV of the Illinois Insurance Code. Retaliatory tax is calculated in the aggregate for all insurance taxes and fees.

Indiana

§ 27-1-20-12

When the taxes, fines, penalties, licenses, fees, deposits, etc., imposed on Indiana insurers or their agents by other states exceed the amounts imposed by Indiana on similar insurers or agents, retaliation will occur.

Iowa

§ 505.14

If the taxes, fees, fines, penalties, licenses, deposits, or other obligations imposed on Iowa insurers or agents are, in the aggregate, in excess of the taxes, fees, fines, or other obligations that Iowa imposes on insurers of other states, retaliation will occur.

Kansas

§ 40-253

When other states charge Kansas insurers taxes, fees, fines, penalties, licenses, or compensation for examination, including taxes or fees based on fire premiums, or require deposits in excess of those Kansas charges insurers domiciled in other states, retaliation will occur on an aggregate basis. In the case of merger or redomestication; retaliation is based on other states' treatment of the surviving company. Does not apply to special purpose assessments or guaranty association assessments under the laws of this or any other state. A tax offset or credit for an assessment shall be treated as a tax paid for purposes of this section.

§ 91A.080 Local Government Premium Tax

If any state retaliates against Kentucky companies because of the imposition of city or county taxes, Kentucky will impose an equal tax on premiums written in this state by insurers domiciled in that state.

Kentucky

§ 304.3-270

When any other state charges Kentucky insurers or their representatives taxes, licenses or other fees, in the aggregate, and any other fines, penalties, deposit requirements, etc., which are in excess of those Kentucky charges similar insurers, retaliation will occur. This does not apply to personal income taxes, nor to ad valorem taxes or real or personal property, nor to special purpose assessments imposed in connection with insurance other than property insurance. Assessments made by guaranty associations shall not be considered or used in determining retaliatory taxation to be imposed upon insurers doing business in Kentucky but organized under the laws of another state

Louisiana

§ 22:836

When any taxes, fines, penalties, licenses, deposits, etc. in the aggregate are imposed by another state on Louisiana insurers, the same taxes, fines, penalties, licenses, deposits, etc. will be imposed by Louisiana on such other states' insurers or agents. Assessments by insurance guaranty funds are not considered in determining retaliatory taxation.

Maine

24-A M.R.S. § 428, 36 M.R.S. § 2519

When any other state or foreign country charges Maine insurers or representatives taxes, licenses and other fees, in the aggregate, or fines, penalties, deposits requirements, etc., that exceed the taxes, licenses and other fees, in the aggregate, or fines, penalties, deposit requirements, etc., that Maine imposes on similar insurers or representatives of another state or country, the same taxes, licenses and other fees, in the aggregate, or fines, penalties or deposit requirements, or obligations, prohibitions or restrictions shall be imposed upon the insurer or representatives of the other state or country. Any tax, license or other fee imposed by any political subdivision shall be deemed imposed by the state. This section does not apply to personal income taxes, or to ad valorem taxes on real or personal property or to special purpose assessments imposed in connection with particular kinds of insurance except property insurance.

Maryland

Ins. § 6-303

When any taxes, licenses or other fees, in the aggregate, and any other fines, penalties, deposit requirements, etc. imposed on Maryland insurers or their agents exceed the taxes, licenses or other fees, in the aggregate, which Maryland would impose upon insurers or agents of such other state, retaliation will occur. Any tax, license or other fee imposed by any political subdivision shall be deemed imposed by the state. This section shall not apply to personal income taxes or to ad valorem taxes on real or personal property nor to special purpose assessments imposed by another state in connection with particular kinds of insurance other than property insurance, nor to assessments by insurance guaranty associations.

§ 175.159

If under the laws of any other state, fines, taxes, penalties, licenses, fees, deposits, etc. imposed on Massachusetts insurers or their agents are in excess of the amounts Massachusetts charges similar insurers or agents, retaliation will occur. The tax return only provides a place for retaliation against other taxes. Retaliation against fees and other charges is computed separately.

§ 63:21

Every foreign life insurer shall pay sum equal to excess of the amount of tax which would be imposed in the same year by the laws of the state or country under which the company is organized, upon a life insurance company incorporated in Massachusetts, or upon its agents, if doing business to the same extent in that state or country.

§ 63:24A

Insurers in any state which does not impose a retaliatory tax on Massachusetts insurers are not subject to retaliation.

§ 63:23

Every foreign company shall pay tax on gross premiums, less certain deductions, but not less than would be imposed by the laws of the state or country under which company is organized upon a like insurer incorporated in Massachusetts, or upon its agents, if doing business to same extent in same state or country

<u>Michigan</u>

§ 500.476a

If a Michigan insurer is required to make a deposit of securities, or pay taxes, fines, penalties special burdens, or any other burdens greater in the aggregate than required by Michigan law for an insurer of another state, retaliation will occur.

<u>Minnesota</u>

§ 60A.14 Retaliation on fees

When any other state's fines, penalties, licenses or fees are in excess of those Minnesota imposes on foreign insurers or their agents, retaliation will occur.

§ 297I.05 Subd. 11 Retaliation on taxes

When any other state charges taxes, fines, penalties, deposits, or fees on a Minnesota insurer and their agents in the aggregate, in excess of what Minnesota would impose on similar insurers or their agents, retaliation will occur. This provision does not apply to companies domiciled in states which do not impose retaliatory taxes or do enforce on a reciprocal basis. Taxes, fines, deposits, penalties, licenses or fees do not include guaranty fund assessments or special purpose assessments for purposes of retaliation.

The tax on HMO's, fire safety surcharge and automobile theft surcharge are not subject to retaliatory tax. The fire relief surcharge is subject to retaliatory tax.

<u>Mississippi</u>

§§ 27-15-123, 27-15-125

When any other state charges Mississippi insurers or representatives any taxes, licenses or fees, in the aggregate, or fines, penalties, deposit requirements, etc., which exceed those Mississippi charges similar insurers or representatives, retaliation will occur. Any tax or fee charged by a political subdivision shall be deemed imposed by the state. This shall not apply to personal income taxes, nor to ad valorem taxes on real or personal property nor to special purpose assessments except those on property insurance.

<u>Missouri</u>

§ 375.916

> If premium taxes or any fees, licenses, penalties deposit requirements or other obligations imposed on Missouri insurers are greater, in the aggregate, than the taxes, fees, licenses, penalties and other requirements Missouri charges similar insurers, retaliation will occur. Any tax, license or fee imposed by any political subdivision shall be considered imposed by the state for purposes of retaliation. This section shall not apply to ad valorem taxes on real or personal property, personal income taxes, or to assessments or credits due to payment of claims of insolvent insurers.

§ 375.017

> The department shall not assess a greater fee for an insurance license or related service based solely on the fact the person is not a resident. The license requirements and continuing education requirements are considered satisfied if the non-resident's state is reciprocal.

Montana

§ 33-2-709

> If taxes, license and other fees, in the aggregate, and any fines, penalties, deposits and other requirements imposed on Montana insurers and representatives exceed those Montana assesses against similar insurers or representatives, retaliation will occur. This does not apply to fees in connection with licensing producers, ad valorem taxes on real or personal property, or special purpose obligations or assessments imposed on particular kinds of insurance other than property insurance.

Nebraska

§ 44-150

> Any taxes, licenses or other fees, in the aggregate, or any fines, penalties, deposit requirements, etc., as would be imposed on Nebraska insurers which would exceed those Nebraska imposes on insurers, agents or representatives of insurers domiciled in other states shall result in a retaliatory tax. Taxes imposed by political subdivisions are considered imposed by the state. This section does not apply to personal income taxes or ad valorem taxes on real or personal property or special purpose obligations or assessments imposed by another state in connection with types of insurance other than property. In the case of merger or redomestication, the home state of the surviving company in a merger as of Dec. 31 at 11:59 p.m. is used for determining retaliatory taxes for the entire year.

§ 44-2417

> Assessments made by guaranty funds of other states shall not be considered taxes, licenses or other fees for purposes of retaliation.

Nevada

§ 680A.330

> Any taxes, licenses or other fees; in the aggregate, and any fines, penalties, deposit requirements, etc. as would be imposed on Nevada insurers which would exceed those Nevada imposes on insurers, agents or representatives of other states shall result in a retaliatory tax. Taxes imposed by political subdivisions are considered imposed by the state. The law does not apply to personal income taxes; or ad valorem taxes on real or personal property; or special purpose obligations or assessments imposed by another state in connection with some kind of insurance other than property insurance except those taken into consideration by the commissioner in determining the extent of retaliatory action.

New Hampshire

§ 400-A:35

> When taxes, fines, penalties, licenses, fees and other obligations imposed on New Hampshire insurers by other states exceed those New Hampshire imposes on other states' insurers, retaliation will occur. New Hampshire retaliates on a tax-for-tax and a fee-for-fee basis on taxes, fines, penalties, licenses, fees, deposits and other obligations, according to the instructions on the tax return.

New Jersey

§ 17:32-15 Insurers Generally

§ 17B:23-5 Life Insurers

> Taxes, fees, fines, penalties, licenses, deposit requirements or other obligation imposed upon New Jersey insurers, reciprocals or interinsurance exchanges or upon their agents which are in excess of such items imposed upon New Jersey companies and agents will result in retaliatory tax. Commissioner may compute tax burden on an aggregate statewide basis. Tax obligations imposed by political subdivisions shall be deemed to be imposed by the state. Does not apply to special purpose assessments in connection with particular kinds of insurance.

New Mexico

§ 59A-5-33

> Taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements or other obligations applied to New Mexico insurers, agents and brokers in other states are subject to retaliation. Taxes or fees imposed by any political subdivision are deemed to be imposed by state. Special purpose assessments, or assessments under guaranty funds not considered except assessments for financing public safety, health and protection.

New York

Insurance Law § 1112

If insurers or agents domiciled in New York are required by another state to deposit securities, or pay taxes, fines, penalties, fees or any other sum greater than those required of similar insurers or agents by New York, retaliation will occur. This does not apply to insurers organized in states whose laws do not impose retaliatory taxes or which grant, on a reciprocal basis, exemptions to New York insurers. The Department of Financial Services computes the retaliation in the manner used by the state of domicile and bills the company.

North Carolina

§ 105-228.8

If premium taxes, on an aggregate basis, imposed on North Carolina companies are in excess of the premium taxes directly imposed upon similar companies by North Carolina law, North Carolina shall impose the same rates on such similar companies. If the laws of another state retaliate on North Carolina companies on other than an aggregate basis, the Secretary of Revenue will retaliate on the same basis. Licenses and fees are not included in retaliatory computation.

Retaliatory tax section does not apply to special purpose obligations or assessments based on premiums imposed in connection with particular kinds of insurance, to the special purpose regulatory charge imposed under § 58-6-25 or to dedicated special purpose taxes based on premiums.

North Dakota

§ 26.1-11-06

Whenever other states charge North Dakota insurers, fines, penalties, taxes or deposits higher than North Dakota would charge similar insurers, retaliation will result on an item-by-item basis.

Ohio

§ 5729.06

If the laws of another state, territory, or nation authorize charges for the privilege of doing business therein or taxes against insurance companies organized in this state exceeding the charges provided in §§ 5729.01 to 5729.15, of the Revised Code, like amounts shall be charged against all insurance companies of such state, territory, or nation doing business in this state, instead of the charges provided by said sections.

§ 3901.86

When the laws of any other state, district, territory or nation impose any taxes, fines, penalties, license fees, deposits of money, securities or their obligations or prohibitions on insurance companies of this state doing business in such state, district, territory or nation, or upon their agents, the same obligations and prohibitions shall be imposed upon insurance companies of such other state, district or nation doing business in the state and upon their agents. Retaliation against fees and taxes in the tax return is made in the aggregate.

Oklahoma

tit. 36 § 628

When taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements, etc., which another state would impose on Oklahoma insurers exceed Oklahoma rates, a retaliatory tax will result. Taxes, licenses or fees imposed by any political subdivision of another state shall be deemed imposed by the state. This section shall not apply to ad valorem taxes on real or personal property. Premium tax, guaranty assessment and filing fees aggregated on the tax form. Pending applications for licensing considered on a fee-by-fee basis.

Oregon

§ 731.854

When taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements or other obligations, imposed on Oregon insurers by other states exceed those Oregon would impose on similar insurers, retaliation will result. Obligations imposed by political subdivisions or agencies will be considered imposed by the state. This does not apply to personal income taxes, ad valorem taxes on real or personal property or to special purpose assessments in connection with particular classes of insurance, except property insurance.

Pennsylvania

§ 40-1-213; 40 P.S. § 50

If any other states impose taxes, fines, penalties, licenses, fees, etc., on Pennsylvania insurers and agents that are higher in the aggregate than Pennsylvania would impose on similar insurers, retaliation will occur.

Puerto Rico

tit. 26 § 335

If taxes, fees, fines, penalties, licenses, deposit requirements, etc., imposed on Puerto Rico companies or agents are in excess of the taxes, fees, penalties, etc., which Puerto Rico would impose on similar insurers, retaliation will occur. Fees are considered on a fee-by-fee basis.

Any tax or obligation imposed by a city or other political subdivision will be considered imposed by the state for purposes of retaliation. This section does not refer to ad valorem taxes on real or personal property or to personal income taxes. However, the premium tax return contains no provision for the calculation of retaliatory taxes or fees, and the department is only applying the provisions concerning retaliation to nonresident agents and brokers and deposit requirements.

Rhode Island

§ 44-17-1 Division of Taxation

In the case of foreign or alien companies, the tax shall not be less in amount than imposed by laws of state or country under which companies are organized. Calculate upon companies and agents if doing business to same extent; includes premium tax and fire marshal tax, etc.

§ 27-2-17 Division of Insurance

Whenever another state charges fees, taxes, deposits or other obligations to Rhode Island insurers, the same charges will be imposed on other companies doing business in Rhode Island. The tax return calculates retaliation on the taxes only. Fees and licenses are separate. Rhode Island retaliatory gross premium tax rates do not apply to insurance companies incorporated or organized under the laws of a state or country whose laws do not impose retaliatory taxes or other charges.

South Carolina

§ 38-7-90

When the laws of another state would subject South Carolina insurers or agents to fees, taxes, obligations, conditions, restrictions or penalties higher than those South Carolina charges similar insurers and agents domiciled in other states, considered in the aggregate, retaliation will occur. Fees, taxes or other obligations imposed by municipalities are included in the calculation.

South Dakota

§§ 58-6-70 to 58-6-73

If any other state imposes on South Dakota insurers or their agents taxes, licenses or fees, in the aggregate, or fines, penalties, deposit requirements or other material obligations which are in excess of those South Dakota charges similar insurers or agents, retaliation will occur. Charges imposed by political subdivisions are considered imposed by the state.

This provision does not apply to that portion of a life insurance policy's annual premiums exceeding $100,000 and to that portion of the annual consideration on an annuity contract exceeding $500,000. (Effective 7/1/08)

This provision shall not apply to ad valorem taxes on property or to special purpose obligations or assessments imposed by another state in connection with particular kinds of insurance other than property insurance; except that deductions allowed on account of property taxes paid shall be taken into account by the department.

Tennessee

§ 56-4-218

When taxes, fees, fines, penalties, licenses, deposit requirements, etc. imposed on Tennessee companies by other states are higher in the aggregate than those Tennessee would charge similar insurers, retaliation will occur. Any license, tax, etc. imposed by a political subdivision is considered imposed by the state.

<u>Texas</u>

I.C. §§ 281.001 to 281.052

Retaliatory taxes are assessed on those foreign or alien insurers, licensed and doing business in Texas, whose state of domicile would assess in total (aggregate) overall higher taxes, assessment and fee obligations on similar Texas insurers than Texas assesses on such insurers operating in this state. Similar Texas insurers are theoretical companies that could write the same types of coverage, such as “life, accident and health,” “property and casualty,” or “title” lines of insurance, as foreign or alien insurance doing business in Texas. A similar company is not required to be of the same size in premium writings or assets.

This subchapter does not apply to a person, company, firm, association, group, corporation, or insurance organization of any kind from another state that engages in business in this state if at least 15% of the voting stock is owned by a corporation organized under the laws of and domiciled in this state, and the person, company, firm, association, group, corporation, or insurance organization met the requirements before 1/30/1957.

A special purpose assessment is an assessment that only applies to insurance companies and for losses or deficits such as guaranty association assessments, high risk health pool assessments, joint underwriting association (JUA) assessments, windstorm association assessments, or other similar assessments, both under the laws of this state and under the laws of any other state or territory. Assessments that may be directly passed through to policyholders or that can otherwise be recouped are not to be used in the retaliatory tax computation.

I.C. §§ 281.001 to 281.052 (cont.)

In determining an insurer’s taxes or other charges, the comptroller may not consider an ad valorem tax on property, a personal income tax, a sales tax, a surcharge that an insurer may recover directly from policyholders, or an assessment for a special purpose, such as an assessment for a guaranty association, high risk health pool, joint underwriting association, windstorm association, or other similar assessments, both under the law of this or other state, or territory.

The Comptroller by rule may enter into a reciprocity agreement with another state under which the parties agree to mutually set aside retaliatory provisions in situations in which this state and the other state determine that retaliation is not the preferred approach to protect their domestic insurers from excessive taxation or other financial obligations.

CAPCO credits should not be included in the retaliatory tax calculation.

The Rural Volunteer Fire Department Assistance Fund assessment and the Automobile Burglary and Theft Prevention Authority assessment may be recouped directly from policyholders and may not be used in Texas retaliatory tax computations.

Title insurance: Based on the “division of premium” between title insurers and title agents in Texas, include only the title insurers portion of the premium and maintenance tax liability due in the retaliatory tax computation for Texas. Because the title agent is responsible for his portion of the premium and maintenance tax in Texas, these amounts should not be included in the Texas column of the retaliatory worksheet.

Utah

§§ 31A-3-401 to 31A-3-402

When other states charge Utah insurers or their representatives taxes, licenses, fees, deposit requirements, etc. in excess of the amounts Utah would charge insurers of that state, retaliation will occur. Any tax imposed by political subdivisions is considered imposed by the state. This provision does not apply to personal income taxes, ad valorem taxes on real or personal property, nor to special purpose obligations in connection with particular kinds of insurance, except when taken in account by the other states for retaliation. Retaliation is considered both on the premium tax return and when documents are filed. The commissioner has authority to waive, by regulation, retaliatory fees for a person doing business in Utah or seeking to do business in Utah.

Vermont

tit. 8 § 3367

When fees, fines, penalties, deposits, etc. imposed on a Vermont insurer are in excess of those Vermont would impose on a similar insurer, retaliation will occur.

tit. 32 § 8555

When taxes imposed by another state on Vermont insurers exceed those Vermont charges foreign insurers, retaliation will occur.

Virginia

§ 38.2-1026

When a Virginia domestic insurer or agent is subject to costs for deposits, taxes, fines, penalties or fees, etc. greater in the aggregate than those imposed on insurers or agents by Virginia, retaliation will occur. Every year the bureau computes average additional charges for use on the tax return where municipalities charge fees and taxes.

Washington

§ 48.14.040

When taxes, licenses, fees, deposits, etc. in the aggregate charged Washington insurers are higher than the taxes, licenses, fees, deposits, etc., which Washington imposes on similar foreign insurers, retaliation will occur. The regulatory surcharge imposed by RCW 48.02.190 is not included in the retaliatory calculation.

West Virginia

§§ 33-3-16, 33-12B-8

> If taxes, fees, fines, penalties, licenses, deposit requirements, etc. imposed on West Virginia insurers, agents or adjusters in the aggregate exceed those imposed by West Virginia on insurers or agents from other states, retaliation will occur. Any tax, license or other obligation imposed by a city, county or other political subdivision shall be deemed to be imposed by the state. The provisions of this section do not apply to ad valorem taxes on real or personal property or to personal income taxes.

Wisconsin

§ 601.55 Fees and Other Obligations

> If another state requires Wisconsin domestics to make a deposit, pay a fee, or pay a tax not included in the Wisconsin computation, which is greater than Wisconsin charges nondomestic insurers, Wisconsin may retaliate on an item-by-item basis.

§ 76.66 Taxes

> If another state requires Wisconsin domestics to pay taxes greater, in the aggregate, than Wisconsin charges similar insurers, retaliation occurs. Taxes defined as general purpose revenue taxes and fire insurance dues less security fund assessment credits.

§ 76.67 Reciprocity

> Wisconsin will not charge foreign insurers more than that insurer's state charges Wisconsin domestics subject to an aggregate minimum of 2% of fire dues, 2% of life insurance and .375% on fire and marine insurance.

Wyoming

§ 26-3-130

> Wyoming will impose the same taxes, licenses and other fees, in the aggregate, on any insurer or its representative, and the same fines, penalties, deposit requirements, etc. as imposed on Wyoming insurers by other states. This does not apply to application fees, examination fees, license fees, appointment and continuation fees for agents, adjusters, service representatives or consultants, or personal income taxes, ad valorem taxes on real or personal property or assessments imposed by other states in connection with particular kinds of insurance except property insurance, except if the other state considers these in determination of retaliatory taxes.

MTC's Non-Income Taxpayer Project - Public Policy Concerns

May 8, 2012

This statement is submitted on behalf of the American Council of Life Insurers, the American Insurance Association and the Property Casualty Insurers Association of America ("the Trades"). The Trades collectively represent the majority of the life and property/casualty insurance industries.

While the Trades recognize the time and effort that has been expended to date by the MTC staff and various members of MTC Committees, we continue to have serious concerns about the project. Those concerns have been well documented throughout the process. The last submission by the Trades to do so was made on March 29th of this year and is available on the MTC's website. However, it has also become increasingly apparent that the Project threatens to transgress the public policymaking domain that is the province of state legislatures.

The selection and design of a tax system that fits the operational realities of the taxed business and the legitimate revenue needs of the taxing state is quintessentially a matter of public policy. For most businesses in most states, the chosen tax system is the corporate income tax system. For the business of insurance in virtually all states, however, different public policy choices have been made by state policymakers. The current, nationwide insurance tax system taxes the insurance business, in all of its aspects, through a gross receipts premiums-based tax, retaliatory tax (unique to this industry), "in lieu" protection against the encroachment of income-based and other tax systems, and a multitude of special assessments. By isolating insurer investment income from the rest of the insurance business, and then distinguishing between investment income that qualifies as part of the insurance business and investment income that does not (and thereby becomes subject to corporate income taxation under the model bill), the Project questions this public policy choice.

Insurance, a service which pervades many aspects of commercial and personal activity in the U.S. is universally regulated by the states. This system regulates an interconnected, nationwide system and is embodied in state constitutions, statutes, regulations, rules and practices that have evolved for over 200 years. The presence of an exclusive and dedicated state regulatory regime is central to this system. Thus, state legislatures generally dedicate special committees to insurance issues. These committees recommend policy and law regarding the business of insurance. State code provisions governing insurance then are set forth in distinct titles, separate from those titles governing other businesses (including financial services businesses).

The Project threatens to impinge upon this state policymaking apparatus principally by applying to insurer investment income a new tax system, predicated on the MTC defining the scope of what constitutes the business of insurance. For example, is a partnership or LLC (majority-owned by an insurer) part of the insurance business when it manages assets for a large, affiliated group of insurance companies? Is such an entity part of the insurance business when it invests in real estate, start-up venture capital enterprises, or low-income housing projects? Is such an entity part of the insurance business when it provides actuarial or claims administration services for an affiliated group of insurance companies? Does the insurance company depart the insurance business and enter into a non-insurance business when (for non-tax, business reasons) it reorganizes a division providing any of these services into a separate partnership or LLC (and vice versa)? The goals of the Project should depend on how state lawmakers answer these questions – taking into account the views of state tax and insurance regulators -- , rather than how they are answered by regulatory bodies alone.

Even the National Association of Insurance Commissioners, through its recent participation in the Project, has expressed concerns about the impacts of the Project on the investments and organization of insurance companies, as well as the costs of insurance to personal and commercial policyholders.

For all these reasons, the Trades believe that the proposed model statute raises many public policy concerns for this unique and complex business that are best determined by state legislators.

Comments on Revised Non-Income Taxpayer Project Model Language

This correspondence is submitted on behalf of the American Council of Life Insurers, the American Insurance Association and the Property Casualty Insurers Association of America, with the recent addition of America's Health Insurance Plans ('the Trades"). It specifically deals with the latest revised model language related to the Non-Income Taxpayer Project that will be the subject of discussion by the Uniformity Committee on February 5th.

The revisions to the model language do not alter the Trades' thinking or strong opinions about this project as articulated in prior submissions. The Trades continue to believe that if there are any issues of "tax equity" here, as the MTC asserts, they relate to the substantially greater state tax burden imposed on the insurance industry by the current insurance tax system and new tax inequities that the model would create. With the issue of "tax equity" at this project's core, the Trades believe the project inappropriately ventures into the policy arena and as such should simply be terminated. Such matters are instead the purview of state legislatures and policy-makers.

Existing Tools to Address MTC Concerns
Relating to Certain Income Tax Abuses/Inequities

1) Roughly 50% of the states have authority to require combined reports for unitary groups. Depending on the state, this authority may allow for inclusion of an insurance company in a combined report with its non-insurance company affiliates.

2) Section 2.B of MTC's Combined Report Model (approved on August 17, 2006) allows for the inclusion of insurance companies in a combined report with their non-insurance company affiliates in certain instances.

3) Roughly ten (10) states subject the insurance company to income tax in addition to premium tax. Generally, those states allow credits for the income taxes against the insurer's premium taxes. In these situations, the insurer is subject to corporate income taxation on the income of a pass-through entity in which it invests.

4) Most states, whether requiring separate company or combined reporting, have statutes, regulations or both that provide the Director or Commissioner of Taxation broad discretionary authority to make a range of adjustments to properly reflect tax when a company has arranged or conducts its business in a manner for which the primary purpose is tax evasion.

5) California law requires a reduction or disallowance of a deduction for dividends received from an overcapitalized insurance company.

6) Judicial doctrines such as sham transaction, economic substance or business purpose may be available to states to challenge tax evasion involving any misuse of insurance companies for state income tax purposes.