What Is The Future Of The Multi-State Allocation Of Nonadmitted Premium Tax Revenue?

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The Dodd-Frank Act contains provisions regulating the nonadmitted insurance market, including the regulation of the taxing of nonadmitted premiums. Prior to the enactment of the Dodd-Frank Act, most states charged a premium tax for nonadmitted insurance. With respect to multi-state risks, the placing surplus lines broker determined the amount of tax owed to each state in which insured risks were located based upon the proportion of risk and premium allocable to each state. States frequently had different tax rates and different allocation methodology and reporting requirements, which resulted in complexity and difficulties for the placing brokers.[1]

The Nonadmitted and Reinsurance Reform Act ("NRRA"), which was part of the Dodd-Frank Act, sought to simplify the regulation of nonadmitted insurance. There are four basic provisions in the NRRA concerning the taxation of nonadmitted insurance premiums. First, the NRRA establishes the insured's "home state" as the only state which may regulate and tax nonadmitted insurance. Specifically with respect to premium taxation, 15 U.S.C. § 8201(a) provides that "No State other than the home

[1] *See* a letter from the National Association of Professional Surplus Lines Offices, Ltd. ("NAPSLO") to Congress concerning a relevant legislative initiative at https://www.napslo.org/wcm/_icore/Content/NAPSLOsearch.aspx?search=premium%20tax

State of an insured may require any premium tax payment for nonadmitted insurance."

Second, the NRRA provides that "The Congress intends that each State adopt nationwide uniform requirements, forms, and procedures, such as an interstate compact, that provide for the reporting, payment, collection, and allocation of premium taxes for nonadmitted insurance consistent with this section."[2]

Third, the NRRA provides that

> "[t]o facilitate the payment of premium taxes among the States, an insured's home State may require surplus lines brokers and insureds who have independently procured insurance to annually file tax allocation reports with the insured's home State detailing the portion of the nonadmitted insurance policy premium or premiums attributable to properties, risks, or exposures located in each State. The filing of a nonadmitted insurance tax allocation report and the payment of tax may be made by a person authorized by the insured to act as its agent."[3]

Finally, although the NRRA appears to contemplate that the home states will tax 100% of nonadmitted insurance premium and allocate the tax for multi-state risks pursuant to some agreement, it reserved to the states the power to address taxation issues and to resolve any issues concerning the allocation of premium tax for risks outside the home state of the insured: "The States may enter into a compact or otherwise establish procedures to allocate among the States the premium taxes paid to an insured's home State described in subsection (a)."[4]

Congress clearly intended that a nationwide system be established to govern these issues. 15 U.S.C. § 8201(b)(4) provides:

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[2] 15 U.S.C. § 8201(b)(4).

[3] 15 U.S.C. § 8201(c).

[4] 15 U.S.C. § 8201(b)(1). For further background on these issues see a news item relating to the 2011 annual convention of NAPSLO at http://www.napslo.org/docs/pdf/nextgen/convention11.pdf.

(4) Nationwide system

> The Congress intends that each State adopt nationwide uniform requirements, forms, and procedures, such as an interstate compact, which provide for the reporting, payment, collection, and allocation of premium taxes for nonadmitted insurance consistent with this section.

To the extent that some home states are collecting 100% of the nonadmitted premium tax for multi-state risks but retaining all of the tax revenue without sharing the revenue with other states in which the insured risks are located, such states arguably are violating this provision of the NRRA. There is no doubt that some states saw an increase in their nonadmitted premium tax revenues as a result of the enactment of the NRRA while other states saw a decline in their tax revenues.

THE TWO TAX ALLOCATION "SOLUTIONS"

Prompted by the NRRA, two arrangements developed which were intended to allocate nonadmitted premium taxes among the states. One never got off the ground due to lack of participation by the states. Almost six years later, many states which joined the other arrangement have withdrawn, leaving as members states which collect less than 1% of the aggregate nationwide nonadmitted premium taxes. The failure of these arrangements raises the question as to whether the states are interested in any multi-state nonadmitted premium tax allocation mechanism.

We have posted several times on our ReinsuranceFocus.com blog concerning the two proposals which were floated after the enactment of the NRRA to address the allocation of nonadmitted premium tax revenue among the states: (1) the Surplus Lines Insurance Multi-State Compliance Compact ("SLIMPACT"), which was supported by The National Conference of Insurance Legislators, The Council of State Governments,

and the National Conference of State Legislatures; and (2) the Nonadmitted Insurance Multi-State Association, Inc. ("NIMA"), which is supported by the National Association of Insurance Commissioners ("NAIC"). SLIMPACT is an interstate compact, while NIMA reserves as much authority as possible for the state insurance commissioners by establishing, through contractual arrangements, a clearinghouse operated by the Florida Surplus Lines Service Office for the reporting, collection, allocation and distribution of tax revenues.[5]

THE CURRENT STATUS OF SLIMPACT AND NIMA

SLIMPACT was to become effective only upon the earlier of the compact's adoption by any ten states or by its adoption by any number of states representing 40% of the nonadmitted U.S. market. At one point nine states had agreed to join SLIMPACT, but it never achieved either of the two requirements for becoming effective, i.e., it never was adopted by ten states or by states representing 40% of the U.S. market.

Unlike SLIMPACT NIMA had no minimum thresholds for the commencement of its operations. At one point NIMA had twelve members, Alaska, Connecticut, Florida, Hawaii, Louisiana, Mississippi, Nebraska, Nevada, Puerto Rico, South Dakota, Utah and Wyoming. NIMA established an associate member category, and Tennessee joined as an associate member. NIMA has been criticized due to the perceived high cost of its operation.

NIMA then started to lose members. By mid-2012, Alaska, Connecticut, Hawaii,

[5] For a further description of SLIMPACT and NIMA, see the Special Focus article titled *Is SLIMPACT Losing Steam? Tennessee Switches to NIMA* at http://reinsurancefocus.com/data/20/1/142/136/1957625/user/2137514/htdocs/blog/wp-content/uploads/2014/05/Special-Focus-surplus-lines-regulation-5.18.14.pdf.

Mississippi, Nebraska and Nevada[6] had withdrawn.[7] Louisiana withdrew in 2015.[8] By early April of this year NIMA had only five members: Florida, South Dakota, Utah, Wyoming and Puerto Rico. Florida, South Dakota, Utah and Wyoming accounted for approximately 13% of the aggregate nationwide nonadmitted premium tax revenue.[9]

Florida, which accounted for approximately 94% of NIMA's tax revenues in 2014, is in the process of withdrawing from NIMA.[10] Without Florida, NIMA would have processed less than 1% of the 2014 nationwide nonadmitted premium tax revenue. Such a minimal total cannot qualify as the uniform nationwide allocation system envisioned by the NRRA.

THE FUTURE OF CONGRESS' DESIRE FOR A NATIONWIDE SYSTEM

The decision of states representing almost all of the nonadmitted premium tax revenue to retain control over the tax revenue they collect rather than share any of the revenue through SLIMPACT, NIMA or some other sharing mechanism arguably violates the NRRA's provision concerning the allocation among the states of premium taxes collected by home states,[11] and casts serious doubt on the proposition that any multi-state arrangement to share nonadmitted premium tax will be agreed to by more than a

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6 *See* http://reinsurancefocus.com/archives/6624.

7 *See* http://02ec4c5.netsolhost.com/blog/archives/6624 and http://02ec4c5.netsolhost.com/blog/archives/6466.

8 *See* http://reinsurancefocus.com/archives/10592.

9 This estimate is based upon the reported nonadmitted premium amounts by state for 2014. *See* http://www.iii.org/publications/a-firm-foundation-how-insurance-supports-the-economy/a-50-state-commitment/surplus-lines. Data was not reported for Puerto Rico.

10 *See* http://www.fslso.com/docs/default-source/bulletins/FSLSOBulletin201603.pdf.

11 *See* 15 U.S.C. § 8201(b)(4).

very few states with very little nonadmitted premium tax revenue.

The NRRA's encouragement of a state sponsored mechanism for the sharing of tax revenue has been insufficient to date to prompt compliance with the announced public policy of nationwide uniformity and tax sharing provisions contained in 15 U.S.C. § 8201(b)(4). Whether this is because of dissatisfaction with the particular provisions or costs of SLIMPACT and NIMA, due to the desire of the home states to retain as much of the revenue they collect as possible, or for some other reason is irrelevant. The desire and intention of Congress that a tax revenue sharing mechanism be put into place was clearly stated in the NRRA, but Congress reserved to the states the authority to effectuate that policy. The consequences of the failure of that to occur remain to be seen. In particular, it remains to be seen whether Congress will cease waiting for the states to address these issues and instead itself enact legislation to implement the NRRA's stated desire for uniform nationwide procedures and some mechanism to share nonadmitted premium tax revenue among the states.

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 This article appeared on the firm's reinsurance and arbitration blog, www.ReinsuranceFocus.com.

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