Legislative Analysis

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SURPLUS LINES TAX EXEMPTION

House Bill 6270 as introduced
Sponsor: Rep. Judy Emmons
Committee: Insurance

First Analysis (7-13-06)

BRIEF SUMMARY: The bill would amend the Insurance Code to provide an exemption from the tax and fee imposed on "unauthorized insurers" (surplus lines insurers) for premiums that are written for insurance that is not offered by authorized insurers.

FISCAL IMPACT: The Office of Financial and Insurance Services has said the bill could result in a loss of $15 million to the state's General Fund. OFIS would also lose revenue from a one-half of one percent of premium administration fee, but says it could make this up from imposing larger assessments on authorized insurers.

THE APPARENT PROBLEM:

The Insurance Code imposes a two percent premium tax on "unauthorized insurers" that transact insurance in the state. The code also assesses an additional one-half of one percent regulatory fee on those premiums. Unauthorized insurers are insurance companies or syndicates that do not have a certificate of authority to operate in the state. Some of those companies are known as "eligible unauthorized insurers" because they are eligible to write business in this state even without state authorization (under the Surplus Lines Insurance Act). They are also known as "surplus lines" insurers. Perhaps the best known of such firms is Lloyds Underwriters of London.

Customers typically seek out coverage from unauthorized insurers because they offer coverages that standard insurance companies do not offer. The Office of Financial and Insurance Services (OFIS) quarterly publishes a list of coverages "generally unavailable" in the authorized market (which include such coverages as animal mortality, kidnap and ransom, non-federal flood insurance, products recall insurance, and high hazard cargo insurance, among others). Licensed insurance producers are supposed to try to place business for the clients first with authorized insurers, then with eligible unauthorized insurers, and only then with other unauthorized insurers (although customers can insist that insurance be placed with a non-eligible unauthorized insurer).

A group called Air Carriers for Tax Fairness has put forth a legislative agenda that identifies a number of state tax policies they consider unduly burdensome. They note that these are difficult times for their industry and for the auto industry, which is a key customer for air cargo operators. One of cited tax issues is the surplus lines tax. The group has complained because aviation insurance is not available in Michigan and thus must be purchased out of state from unauthorized insurers, the surplus lines tax on such coverage cannot be avoided and unfairly drives up the cost of doing business for air carriers.

THE CONTENT OF THE BILL:

The bill would amend the Insurance Code to provide an exemption from the tax and fee imposed on surplus lines insurers ("unauthorized insurers") for premiums that are written for insurance that is not offered by authorized insurers.

MCL 500.451

BACKGROUND INFORMATION:

Under the Insurance Code, an "authorized" insurer is an insurer duly authorized, by a subsisting certificate of authority issued by the commissioner, to transact insurance in this state. An "unauthorized" insurer is an insurer not so authorized to transact insurance in this state. The code defines an "eligible unauthorized insurer" as an insurer not authorized to transact insurance in this state but eligible to write insurance business under the Surplus Lines Insurance Act.

The term "surplus lines insurance" refers to insurance in this state procured from or continued or renewed with an unauthorized insurer and includes all of the following, whether effected by mail or otherwise: insurance for which applications are solicited from persons resident or located in this state; insurance for which contracts of insurance are issued or delivered to persons resident or located in this state; insurance that is procured through negotiations or by an application occurring in whole or in part in this state or made within or from within this state; and insurance for which premiums, in whole or in part, are remitted directly or indirectly within or from within this state.

ARGUMENTS:

For:

Representatives of Michigan-based air cargo carriers have urged the repeal of the premium tax on the surplus lines insurance they must purchase. Carriers say that the insurance they need is not available in the state but must be purchased from out-of-state unauthorized insurers. They say that if the purpose of the surplus lines tax is to encourage in-state insurance purchases, it is unfair to levy the tax when Michigan firms are forced to go out of state to specialized companies for insurance coverage. The tax, they say, is unreasonable, drives up their costs, and does not further the goal of encouraging in-state insurance purchases. The legislation they are promoting would exempt unauthorized insurers from the surplus lines tax when the insurance in question is not offered by authorized insurers.

Against:

State regulators say that unauthorized insurers are not licensed to operate in Michigan, do not contribute to state guaranty funds (to protect consumers against financial failures), and do not pay either the single business tax or retaliatory taxes. Michigan-based firms and out-of-state firms authorized to do business in the state must contribute to guaranty funds, pay either the SBT or retaliatory taxes, and must pay the fees that cover the cost of regulating them for financial soundness. The bill, then, gives unauthorized insurers special treatment to the disadvantage of authorized insurers, including Michigan-based insurers. Moreover, it would reduce state General Fund revenues by $15 million. It also would deprive OFIS of regulatory revenue that would likely have to be made up by increasing assessments on authorized insurers.

The bill also poses administrative difficulties. OFIS claims that while it does provide a list of products "generally unavailable in the authorized market" (which is a way of identifying surplus lines products) it does not track what coverages are "offered" by authorized insurers on a daily or even monthly basis. As a result, the taxes in question would have to first be collected and then rebated after an audit, if a rebate was determined to be warranted. It is not clear what mechanism would be used to provide this rebate or credit.

POSITIONS:

Air Carriers for Tax Fairness testified in support of the bill. (6-28-06)

The Office of Financial and Insurance Services (OFIS) is opposed to the bill. (6-28-06)

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