

**REPORT  
OF THE NAPSLO SPECIAL COMMITTEE  
ON SURPLUS LINES PREMIUM TAXATION**

***“PRINCIPLES AND GUIDELINES  
FOR A  
CONSISTENT APPROACH TO TAXATION”***

**SEPTEMBER 2000**



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Excess and surplus lines regulatory and tax laws vary significantly from state to state. When a surplus lines insurance policy provides coverage on risks in more than one state, these laws often conflict, to the point, that full compliance, by the broker that placed the policy, with the laws and regulations of each state is virtually impossible. At a minimum, these inconsistencies in state laws make multi-state surplus lines transactions complicated and confusing, and add unnecessary costs to the transaction. At their worst, the inconsistencies and conflicts actually frustrate the transaction to the detriment of the consumer and the broker.

In discussing this industry wide dilemma among members of an industry based volunteer committee established by NAPSLO, certain principles and guidelines were discussed and established which, if implemented, would diminish existing compliance dilemmas and represent a positive approach to surplus lines tax remittance and overall surplus lines regulation.

### **PRINCIPLES AND GUIDELINES**

- 1) Excess and surplus lines brokers want to comply with applicable laws in all states in conducting their business.
- 2) Full compliance, in any given transaction, includes the payment of all taxes to all jurisdictions whose tax laws apply to an excess and surplus line transaction.
- 3) The establishment of clear and consistent surplus lines tax laws, in and among all states, will establish tax payment certainty in surplus lines transactions. This will relieve current concerns surplus lines brokers have regarding the potential regulatory or legal jeopardy arising out of their attempt to comply with conflicting and confusing surplus lines premium tax remittance laws.
- 4) While the creation, among the states, of a uniform regulatory and tax remittance system for surplus lines transactions is an ideal goal, it is not a practical one at this time. It is, however, possible to harmonize state laws so that the state regulatory system is more consistent and less complicated and allows for easier compliance in multi-state surplus lines transactions.
- 5) Harmonizing state laws is most readily accomplished by: (1) identifying the common features that currently exist in various state excess and surplus lines laws and (2) securing, in those states whose laws do not contain these common features, the necessary legislative and regulatory changes to obtain commonality, consistency and compatibility among the excess and surplus lines laws of all the states.
- 6) The vast majority of state excess and surplus lines tax laws require licensed surplus lines brokers to remit premium tax to the state on the premium represented by the portion of the risk located or to be performed in the state. This is known as the “allocation approach” to surplus lines premium taxation. Remittance of the surplus lines premium tax due to the state under the “allocation approach” is the legal obligation of the excess and surplus lines broker. Under circumstances where a surplus lines policy includes coverage on locations or on risks that are to be performed in states other than that in which the excess and surplus lines broker

is licensed and obligated to remit the tax, a tax on the portion of the premium represented by such locations or risks may be imposed by the state or states in which the risks are located or to be performed. This tax is not a surplus lines tax, but an independent procurement tax. In contrast to the surplus lines tax, the remittance of the independent procurement tax is the legal obligation of the insured.

- 7) If all states imposed a tax on excess and surplus lines transactions in a similar manner, many of the conflicts and inconsistencies in state laws which create tax remittance problems for surplus lines brokers would be eliminated. Under current surplus lines tax laws, the conflicts and inconsistencies occur primarily when: (1) the state in which the broker is resident and licensed imposes a tax on the entire premium and another state or other states impose a tax on an allocated share of the premium resulting in double taxation on portions of the premium and (2) two or more states impose a tax on their allocated portion of the premium and each state requires filings to be made by the placing broker or by a broker licensed in the state or states that impose the tax on the allocated premium
- 8) With the enactment of Gramm-Leach-Bliley Act, harmonizing the state surplus lines laws has become critical as part of the effort to create uniform or reciprocal producer licensing laws among the states.
- 9) In today's economy, surplus lines transactions frequently involve multi-state risks not a single state exposure. The single state exposure was the common way excess and surplus lines risks were insured when the excess and surplus lines laws were first adopted over 110 years ago.
- 10) State regulators and legislators are being challenged to create greater uniformity in state insurance regulatory laws, especially in the area of producer licensing. If the states are successful in this effort, an efficient "national" system of insurance regulation, controlled by the states, will emerge. If the states fail to achieve a reduction in the administrative burden of state regulatory compliance, then a "federal" system of insurance regulation will be imposed. The regulation of excess and surplus lines brokers and agents must be an integral part of any "national" program of insurance regulation.
- 11) If tax remittance procedures and allocation formulas for surplus lines and independent procurement taxes were made more consistent, it is possible that the NITCH (Nonadmitted Insurance Tax Clearinghouse) project, on which the industry and regulators worked so diligently a few years ago, could be revitalized and moved forward.
- 12) All states should provide for a waiver of premium allocation for personal and commercial lines policies where the policy premium is de minimus so as not to justify the cost involved in allocating premium and calculating and remitting tax to other states. The premium level at which such a waiver should be allowed is \$1,000 of premium allocated to a state under a particular policy.

- 13) The harmonization of excess and surplus lines tax laws will involve approaching states: (1) that do not use the allocation approach to surplus lines taxation and request that they change tax laws to an allocation approach; (2) that do not have independent procurement tax laws and request that such laws be enacted in those states; and (3) that mandate that a resident excess and surplus lines broker be involved in insuring a risk in their state which is part of a transaction conducted outside their state and adopt policies that recognize and accept, without legal ramifications to the filing broker, the validity of an out-of-state filing appropriately made by a licensed excess and surplus lines broker of another state.