

DEPARTMENT OF INSURANCE

Legal Division, Enforcement Bureau

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PERSONAL INSURANCE FEDERATION

MEMORANDUM

TO: Certain Interested and Affected Parties

FROM: Geoffrey F. Margolis
300 Capitol Mall, 17th Floor
Tel: 916-492-3558 / Fax: 916-324-1883

DATE: March 25, 2008

RE: Invitation to Prenotice Public Discussions on the Adoption of
Contemplated Reporting and Filing Premium Taxes Regulations (REG-
2007-00002)

Pursuant to California Government Code Section 11346.45, California Insurance Commissioner Steve Poizner will hold prenotice public discussions regarding the adoption of California Code of Regulations, Title 10, Chapter 5, Subchapter 3, Article 6, Sections 2340.1 through 2340.7 (the "Reporting and Filing Premium Taxes" Regulation). Section 13170 of the California Revenue and Taxation Code authorizes the Commissioner to promulgate these regulations. (A copy of the proposed regulation is attached.)

You are hereby invited to participate in these prenotice public discussions. The purpose of these discussions is to permit certain interested and affected persons an opportunity to present statements or comments with respect to the proposed regulations.

Public discussions will be held on the following date, at the times and location specified below:

Date: Thursday, April 10, 2008

Location: California Department of Insurance
Hearing Room, 13th Floor
300 Capitol Mall
Sacramento, CA 95814

Time: 10:00 a.m. to 12:00 p.m.; 1:30 p.m. to 4:00 p.m.

The facility to be used for these public discussions is accessible to persons with mobility impairments. Persons with sight or hearing impairments are requested to notify the undersigned, by Monday, April 7, 2008, in order to make special arrangements.

Space is limited so we are asking that you limit your representation to one individual. In the event that more people indicate a desire to attend than the space can handle, the Department, at

its sole discretion, may hold a second public discussion in Northern or Southern California later in April or May of 2008.

Participants should be prepared to present specific comments on, and alternate regulation language for, the enclosed draft regulation text at this scheduled public discussion. It is requested that all persons interested in participating submit written statements outlining any issues, comments, or editorial suggestions no later than April 7, 2008. Any person desiring to provide written comments only, without providing oral comments, must file those comments with the Department in writing no later than April 10, 2008 at 5:00 p.m.

All persons are invited to submit written statements.

Please be advised that participation in these prenotice discussions will be in addition to, and not in substitution for, any participation in the formal rulemaking process. This invitation to prenotice public discussions does not constitute Notice of Proposed Action under the Administrative Procedure Act. Consequently, comments (oral or written) received in connection with these prenotice discussions will not be included in the rulemaking file, which will not be opened until the time formal notice is issued. Similarly, the Department is not required to respond to comments received before that time. For this reason, if you wish to have comments included in the rulemaking file, or to require the Department to respond to them as part of the process by which it adopts the Reporting and Filing Premium Taxes Regulations, you must present your comments during the formal public comment period according to the procedures outlined in the Notice of Proposed Action at the time that document is issued, regardless of whether the comments have been made in connection with these prenotice public discussions. The Commissioner nonetheless welcomes your participation in these discussions, and hopes that the regulations that subsequently will be proposed can benefit from your input.

Participants are requested to RSVP by 5:00 p.m. on Monday, April 7, 2008, by sending an e-mail to the following address pizarroc@insurance.ca.gov. When you RSVP, please indicate the closest major metropolitan area to your business location. In the event that too many people RSVP, you may be contacted regarding attending a possible second public discussion in Northern or Southern California.

All inquiries (except RSVPs) regarding the adoption of the contemplated regulations and these public discussions should be directed to the undersigned.

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California Code of Regulations, Title 10, Chapter 5

Subchapter 3. Insurers

Article 6. Taxation

Section 2340 Reporting and Filing Premium Taxes

Section 2340.1. Preamble.

An annual tax is imposed on each insurer and surplus line broker doing business in this State. In the case of an insurer, except those transacting title insurance, home protection companies and surplus line brokers, the basis of the annual tax is the amount of gross premiums, less return premiums, received in such year by such insurer other than premiums received for reinsurance and for ocean marine insurance. The annual tax may be reported to the California Department of Insurance on a cash basis or on an accrual basis.

The Insurance Commissioner is required to examine the tax return and determine the correct amount of tax to be paid by insurers, home protection companies and surplus line brokers. If the Commissioner determines that the amount of tax disclosed by the insurer's, home protection company's or surplus line broker's tax return and assessed by the board is less than the amount of the tax the Commissioner's examination determines must be paid, he shall propose in writing to the Board of Equalization a deficiency assessment for the difference.

Pursuant to California Revenue and Taxation Code Section 13170, these regulations relate to the administration and enforcement of insurance taxation by the Insurance Commissioner of the State of California.

NOTE: Authority cited: Section 13170, Revenue and Taxation Code. Reference: Article XII, Section 28, California Constitution, Sections 12001, 12201, 12221, 12231, 12232, 12302, 12303, 12304, 12421, and 12422; Revenue and Taxation Code, Sections 19, 20, 21, 28, 47, 736, 1530, 1774 and 12740, Insurance Code.

Section 2340.2. Definitions.

Unless the context otherwise requires, the definitions set forth in this article govern the construction of this subchapter.

- (a) Accrual basis. Accrual basis accounting is a method of calculating premium tax based upon premiums, as identified on Schedule T of the insurer's Annual Statement, that are written by the insurer during a given tax year.
- (b) Adjustments. Adjustments are increases or decreases in taxable premium.
- (c) Advance premiums. Advance premiums result when policies are processed and the premium has been paid prior to the effective date of the policy.

- (d) Assumed business. Assumed business means reinsurance premiums that are accepted in part or in whole from another insurer.
- (e) Cash Basis. Cash Basis accounting is a method of calculating premium tax based upon premiums that are received and collected by the insurer during a given tax year, less any premiums returned during the same tax year.
- (f) Charged-off. Charged-off describes premiums balances which have been determined to be uncollectible and written off as losses.
- (g) Contractually due. Contractually due means an obligation that is due and owing to the insurer and would be included in taxable premium under an accrual basis.
- (h) Deduction. A deduction is any item or expenditure subtracted from gross premiums to reduce the amount subject to tax.
- (i) Direct bill. Direct bill is when a Premium is directly billed by the insurer to the insured.
- (j) Direct business. Direct business means premiums written and/or received in transactions conducted directly with the insured.
- (k) Examination by the Commissioner. Examination by the Commissioner includes all actions conducted by the Department of Insurance in examining the insurer's tax return and/or determining the correct amount of tax to be paid by an insurer or surplus line broker, and includes but is not limited to desk reviews, field examinations and the like.
- (l) General ledger. The general ledger is a record that contains the accounts that make up the insurer's financial statements.
- (m) Line of business. Line of business means the general classification of business as utilized in the insurance industry, such as Fire, Allied Lines and Homeowners.
- (n) NAIC. The NAIC is the National Association of Insurance Commissioners, which is an organization of insurance regulators from the 50 states, the District of Columbia and the five U.S. territories.
- (o) NAIC Annual Statement Blank 2006. The NAIC Annual Statement Blank 2006 is an annual financial statement forms used by insurers prescribed by NAIC, and any successor NAIC Annual Statement Blank is hereby incorporated by reference.
- (p) NAIC Schedule T 2006. The NAIC Schedule T 2006 is an NAIC schedule found in the NAIC Annual Statement Blanks that is intended to exhibit the amount of premiums written, allocated by states and territories, and any successor NAIC Schedule T is hereby incorporated by reference.

- (q) Open tax year. An open tax year is any taxable year that is not covered by the limitations found in California Revenue and Taxation Code Section 12978.
- (r) Policy register. The policy register is a report that shows all of the policies transacted during a particular reporting year.
- (s) Pooled business. Pooled business is the combination of business held by an organization of insurers or reinsurers through which particular types of risks are written with the premiums, losses, and expenses shared in agreed amounts among the insurers belonging to the pool.
- (t) Reconciliation. Reconciliation means to adjust the differences between two sets of records to ensure the figures are in agreement and are accurate.
- (u) Recoveries. Recoveries are funds received by the insurer during a given tax year for premium balances Charged-off during a previous tax year.
- (v) Taxpayer. Taxpayer includes insurers, home protections companies and surplus line brokers who are required to file a premium tax return with the Insurance Commissioner.

NOTE: Authority cited: Section 13170, Revenue and Taxation Code; Reference: Article XII, Section 28, California Constitution, Sections 12001, 12201, 12221, 12231, 12232, 12302, 12303, 12304, 12421, and 12422; Revenue and Taxation Code, Sections 19, 20, 21, 28, 47, 736, 1530, 1774 and 12740, Insurance Code.

Section 2340.3. Selection of Cash or Accrual Basis

- (a) An insurer, that is not a title insurer, home protection company or surplus line broker, may elect to file its premium taxes on an accrual basis or on a cash basis, but it shall not be permitted, except in the case of a merger completed during the tax year in question between an accrual basis taxpayer and a cash basis taxpayer, to file its premium taxes in part on an accrual and in part on a cash basis.
- (b) An insurer, that is not a title insurer, home protection company or surplus line broker, may switch from filing its premium taxes on an accrual basis to a cash basis for any open tax year.
- (c) No insurer is required to switch from filing its premium taxes on an accrual basis to a cash basis.
- (d) No title insurer, home protection company or surplus line broker shall be permitted to file its premium taxes on a cash basis.
- (e) In the event that an insurer does file its premium taxes for any tax year on a cash basis, it shall not, unless it merges with an accrual basis taxpayer, file its premium tax, for any subsequent tax year on an accrual basis.

- (f) In the case of a merger between an accrual basis taxpayer and a cash basis taxpayer, the surviving insurer shall be permitted to file its premium taxes in part on an accrual and in part on a cash basis only for the tax year in which the merger occurred. Notwithstanding subdivision (a) of this subdivision 2340.3, if the Commissioner, in his discretion may allow the surviving insurer to file its premium taxes in part on an accrual basis and in part on a cash basis for a particular subsequent tax year.

NOTE: Authority cited: Section 13170, Revenue and Taxation Code. Reference: Article XII, Section 28, California Constitution, Sections 12001, 12201, 12221, 12231, 12232, 12302, 12303, 12304, 12421, and 12422; Revenue and Taxation Code, Sections 19, 20, 21, 28, 47, 736, 1530, 1774 and 12740, Insurance Code.

Section 2340.4. Use of Estimates

- (a) The use of estimates to determine premiums received is not permitted for purposes of reporting and paying the California premium tax. Taxpayers shall be permitted only to use actual premiums received, regardless of whether the premium is contractually due. "Premiums received" includes premium collected by the insurer's agents but not yet received by the insurer.
- (b) Only actual uncollected premiums shall be permitted to be taken as deductions or adjustments to taxable premiums as identified on the taxpayer's NAIC Schedule T.

NOTE: Authority cited: Section 13170, Revenue and Taxation Code. Reference: Article XII, Section 28, California Constitution, Sections 12001, 12201, 12221, 12231, 12232, 12302, 12303, 12304, 12421, and 12422; Revenue and Taxation Code, Sections 19, 20, 21, 28, 47, 736, 1530, 1774 and 12740, Insurance Code.

2340.5 Cash Basis Taxpayers

In addition to any other insurance tax premium filing requirements or instructions, cash basis taxpayers must do the following:

- (a) Cash Basis taxpayers must submit with the premium tax return filed with the Department a reconciliation of Premiums and Considerations (currently reflected on Page 2, Col. 1, Lines 13.1, 13.2, and 13.3 of the NAIC 2006 Annual Statement Blank) broken down by direct versus assumed business, by line of business, and for direct business only, by state. If the taxpayer's business is pooled, the reconciliation must be prepared such that premiums received are accounted with the premiums, losses, and expenses in the insurer's agreed amount for the pool.
- (b) Cash Basis taxpayers must provide, with the company's filed tax return, a statement signed by an officer of the company under penalty of perjury to the effect that: (1) the company's accounting system is capable of accurately reflecting all premiums received ("Cash" basis) by line of business and by state and (2) the company has accurately accounted for and reported its California premium taxes using the "Cash" basis method.
- (c) Cash Basis taxpayers must submit a reconciliation of taxable advance premiums collected broken-down by state.

- (d) The Commissioner in his discretion may require the taxpayer to provide a detailed policy listing/report showing the insured's name, policy number, effective date, premium amount and any other general ledger documentation that the Commissioner may specify to substantiate the reconciliation of the premiums and consideration, and in so doing, any direct bill items should be shown in policy level detail, and agents' balances must be shown in policy level detail within each agent.

NOTE: Authority cited: Section 13170, Revenue and Taxation Code. Reference: Article XII, Section 28, California Constitution, Sections 12001, 12201, 12221, 12231, 12232, 12302, 12303, 12304, 12421, and 12422; Revenue and Taxation Code, Sections 19, 20, 21, 28, 47, 736, 1530, 1774 and 12740; Insurance Code.

2340.6 Converting from Accrual Basis to Cash Basis

If a taxpayer converts to the cash basis method, premium balances "charged off" may not be taken as a deduction by the taxpayer on its California premium tax return unless premium tax for the "charged-off" premiums was previously paid, and a reconciliation of premium balances charged off or recovered broken-down by state is submitted.

NOTE: Authority cited: Section 13170, Revenue and Taxation Code. Reference: Article XII, Section 28, California Constitution, Sections 12001, 12201, 12221, 12231, 12232, 12302, 12303, 12304, 12421, and 12422; Revenue and Taxation Code, Sections 19, 20, 21, 28, 47, 736, 1530, 1774 and 12740; Insurance Code.

2340.7 Expense of Examinations by the Insurance Commissioner

All examinations shall be at the expense of the insurer, organization or person examined. However, in the discretion of the Commissioner, the Commissioner may determine that an examination may be conducted at the expense of the state. The costs and expenses of any such examination, conducted at the expense of the insurer, organization or person examine, shall be paid from the support appropriation for the Department of Insurance current at the time of the examination but shall be charged to and collected from the insurer, organization or person examined. If any such insurer, organization, or person refuses to pay such costs and expenses promptly when required to do so by the Comhmissioner, the Commissioner may, in his discretion, refuse to issue its certificate of authority, certificate of exemption or license, as the case may be, and may revoke any existing certificate of authority, certificate of exemption or license.

NOTE: Authority cited: Section 13170, Revenue and Taxation Code. Reference: Article XII, Section 28, California Constitution, Sections 12001, 12201, 12221, 12231, 12232, 12302, 12303, 12304, 12421, and 12422; Revenue and Taxation Code, Sections 19, 20, 21, 28, 47, 736, 1530, 1774 and 12740; Insurance Code.