

**DEPARTMENT OF INSURANCE**  
Legal Division, Enforcement Bureau

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PERSONAL INSURANCE OPERATIONS

**MEMORANDUM**

**TO:** Certain Interested and Affected Parties

**FROM:** LASZLO KOMJATHY, JR.  
45 Fremont Street, 24<sup>th</sup> Floor  
Tel: 415-538-4413 / Fax: 415-904-5896

**DATE:** December 28, 2009

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

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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: Tuesday, January 19, 2009

Location: California Department of Insurance  
Hearing Room, 22nd Floor  
45 Fremont Street  
San Francisco, CA 94105

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 Friday, January 15, 2009, 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 January 15, 2009. Any person desiring to provide written comments only, without providing oral comments, must file those comments with the Department in writing no later than January 19, 2009 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 Friday, January 15, 2009, by sending an e-mail to the following address [hipponj@insurance.ca.gov](mailto:hipponj@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.

Laszlo Komjathy, Jr.

Staff Counsel IV

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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 on premiums is imposed on each insurer and surplus line broker doing business in this State. With respect to insurers, 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 on premiums is required to be paid based on premiums received. Historically, the California Department of Insurance interpreted the statute to require that insurers report and file premium taxes based on premiums written pursuant to NAIC Annual Statement Schedule T rather than on premiums received or cash basis. Relying on the California Department of Insurance's mandates, many insurers set up their accounting and reporting systems to comport with California Department of Insurance policy on reporting and paying premium taxes.

The State Board of Equalization in a Memorandum Opinion adopted on December 12, 2006 in *Matter of the Petitions for Redetermination Under the Tax on Insurers Law of California Automobile Insurance Company* held that an insurer must pay taxes on premiums received and not on premiums written. The payment of taxes by an insurer on premiums written rather than premiums received results in an advance payment of taxes due. Because insurers have relied on the directives of the California Department of Insurance, the State Board of Equalization concluded that it would be unfair and inequitable to mandate that all insurers immediately revise their accounting and reporting systems to report and pay taxes on premiums received. To avoid this inequitable result, an insurer may elect to continue reporting its premium taxes to the California Department of Insurance on an accrual basis so long as the taxes paid on an accrual basis are not less than the amount that would be due if reported pursuant to the requirements of Insurance Code § 12221.

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 tax return and assessed by the State Board of Equalization is less than the amount of tax disclosed by his or her examination, he or she shall propose in writing to the State 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. State Board of Equalization Memorandum Opinion in California Automobile Insurance Company (December 12, 2006)

## **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) 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.
- (c) Collected Direct Premiums. For purposes of this Article, the term Collected Direct Premiums or premiums received is defined as that portion of premiums directly written by the Insurer, including any consideration that was due on or before the end of the tax year for which the insurer is filing, but for which the insurer has received payment.
- (d) Direct Premiums. Direct Premiums means premiums written and/or received in transactions conducted directly with the insured, but does not include premiums written on reinsurance business.
- (e) Gross Premiums. For purposes of this Article, the term gross premiums as referenced in California Revenue and Taxation Code section 12221, does not include premiums received for reinsurance, ocean marine insurance, title insurance, home protection contract fees nor surplus line transactions.
- (f) Insurer. For purposes of this Article, the term Insurer is defined by California Insurance Code Section 23, and includes those listed in California Revenue and Taxation Code Section 12003, however, it does not include those transacting ocean marine insurance or title insurance, home protection companies or surplus line brokers.
- (g) 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.
- (h) NAIC Annual Statement Schedule T. The NAIC Annual Statement Schedule T 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.

- (i) 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.
- (j) Premium Collection Activity. For purposes of this Article, the term Premium Collection Activity includes any or all of the following: insurance lines and types, billing plans, payment plans, and bad debt percentage.
- (k) Uncollected Direct Premiums. For purposes of this Article, the term Uncollected Direct Premiums is defined as that portion of premiums and consideration that was directly written by the Insurer and was due on or before the end of the tax year for which the insurer is filing, but for which the insurer has not received payment.

NOTE: Authority cited: Section 13170, Revenue and Taxation Code. Reference: Article XII, Section 28, California Constitution, Sections 12001, 12003, 12201, 12221, 12231, 12232, 12302, 12303, 12304, 12421, and 12422; Revenue and Taxation Code, Sections 19, 20, 21, 24, 28, 47, 736, 1530, 1774 and 12740, Insurance Code.

### **Section 2340.3. Selection of Cash or Accrual Basis**

- (a) An insurer is required to pay taxes on all premiums received during the tax year.
- (b) An insurer may file its return for premium taxes on either a cash basis or accrual basis so long as the amount of taxes paid is equivalent to or greater than the amount of taxes that would be due for premiums received by the insurer.
- (c) If an insurer elects to file on an accrual basis the insurer must pay premium taxes on all Direct Premium reported on its return and the State must receive said premium taxes at the same time or earlier than if the premium taxes would have been paid by the insurer if it would have filed using a cash basis, and such a filing results in the State receiving an amount greater than or equal to the amount it would have received in premium taxes had the insurer filed using a cash basis.
- (d) An insurer is permitted, but not required, to switch from an accrual basis to a cash basis under which it files its premium taxes for any open tax year. However, once an insurer elects to switch from an accrual basis to a cash basis the insurer thereafter is always required to file on a cash basis.
- (e) Except in the case of a merger completed during the tax year in question between an accrual basis taxpayer and a cash basis taxpayer, it shall not be permitted for an insurer to file its premium taxes in part on an accrual and in part on a cash basis. Under such circumstances, 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. The Commissioner, in his or her sole 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. State Board of Equalization Memorandum Opinion in California Automobile Insurance Company (December 12, 2006)

#### **2340.4 Insurers Filing on a Cash Basis**

In addition to any other insurance tax premium filing requirements or instructions, any insurer that files on a cash basis shall do the following:

- (a) Calculate its taxes on Collected Direct Premiums in accordance with Revenue and Taxation Code section 12221; or,
- (b) For tax year 2012 and/or earlier open tax years, calculate its taxes on Direct Premiums, subject to the requirements of Revenue and Taxation Code Section 12221, using a ratio of the insurer's Direct Premiums written upon business transacted in this State to the insurer's total Direct Premiums written, as reported on the insurer's NAIC Annual Statement Schedule T, and apply it to either the insurer's Collected Direct Premiums or the insurer's Uncollected Direct Premiums, as long as at the time of filing the insurer provides sufficient information, in the Commissioner's sole discretion, that establishes the following:
  - (1) That the Insurer without undue hardship cannot readily provide the data necessary to calculate its taxes in accordance with section 2340.4(a), and that the Insurer provides the Commissioner with an attestation affirming that the same is true; and,
  - (2) That the insurer's Premium Collection Activity on business transacted in this State is substantially similar to the insurer's Premium Collection Activity on business transacted in all states.

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; State Board of Equalization Memorandum Opinion in California Automobile Insurance Company (December 12, 2006)