PRIVATE LETTER RULING

REQUEST LETTER

08-003

February 29, 2008

TAXPAYER REPRESENTATIVE
ADDRESS

To Whom It May Concern:

We are writing on behalf of our client, COMPANY ("COMPANY"), to request a letter ruling with respect to the taxation of a domestic insurance company, which is legally and commercially domiciled in Utah. COMPANY is currently inactive. Beginning on January 1, 2009, within Utah COMPANY will provide Medicare Part D prescription drug plans throughout the 50 states and District of Columbia. In advance of our submitting this request, we have discussed this matter and received the enclosed informal guidance letter dated December 26, 2007, from TAX COMMISSION REPRESENTATIVE, Taxpayer Services Division. We have included below the factual background and our analysis of the issues.

Background

EMPLOYEE of the Utah Insurance Department has confirmed that COMPANY is licensed as a life and health insurance company under Utah Code, Title 31A, Chapter 5. Beginning on January 1, 2009, COMPANY will be in the business of providing prescription drug plans ("PDP") under Medicare Part D as established by the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Pub. L. No. 108-173, 117 Stat. 2066 (2003). These plans will provide prescription drug benefits to approximately 441,000 Medicare participants in all 50 states and the District of Columbia.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 requires prescription drug plan sponsors to be licensed under state law as a risk-bearing entity, such as an insurer or health maintenance organization, eligible to offer health insurance or health benefits coverage in each state in which the applicant offers a prescription drug plan. COMPANY is currently admitted to write life and/or health insurance in 46 states and the District of Columbia, and has submitted applications to be admitted to write

insurance in the remaining four states in which it will offer a prescription drug plan. The prescription drug pans that will be offered by COMPANY are subject to an annual bidding requirement of and regulatory approval by The Federal Centers for Medicare and Medicaid Services ("CMS").

While many state insurance laws are well-established, CMS continues to provide new guidance in an attempt to assist sponsors and state regulators in determining the appropriate applicability of state insurance laws in the context of the Medicare prescription drug plans.

Analysis

1. *If COMPANY is exempt from the insurance premium tax under Utah Code Section 59-9-101(5)(a), will Utah Code Section 59-7-102(1)(c) apply to COMPANY thus exempting it from income and franchise tax under Utah Code Section 59-7-104?*

COMPANY is an admitted insurer and is subject to the provisions of Utah Code, Title 59, Chapter 9, Taxation of Admitted Insurers, and is an insurer licensed under Utah Code, Title 31A, Chapter 5, Life and Health Insurance Company.

Admitted insurers are subject to and are required to file tax returns pursuant to Utah Code, Title 59, Chapter 9. However, pursuant to Utah Code Section 59-9-101(5)(a), insurers licensed under Utah Code, Title 31A, Chapter 5, are not subject to the premium tax in Section 59-9-101(1)(a) on the insurer's qualifying health care insurance premiums. An insurer is required to report all premiums received from direct business in Utah, but may deduct certain premiums such as qualifying Utah health care premiums. Where the insurer's qualifying health care premiums are equal to its total reportable premiums, the insurer's net taxable premiums would be zero and could result in zero tax due.

Utah Code Section 59-7-102(1)© exempts from application of the state's income and franchise tax under Utah Code Section 59-7-104 "an insurance company that is **otherwise taxed on the insurance company's premiums** under Chapter 9, Taxation of Admitted Insurers." (Emphasis added.)

Despite having zero net taxable premiums and zero premiums tax due, an insurer will still qualify for the exemption from the Utah income and franchise tax under Utah Code Section 59-7-102(1)©, provided it complies with the premiums tax reporting and filing requirements of Utah Code, Title 59, chapter 9. For purposes of determining application of the income and franchise tax exemption under Utah Code Section 59-7-102(1)©, an insurer is in effect treated as "otherwise taxed on its insurance premiums" by filing its Utah insurance premium tax return irrespective of deductions that result in a zero liability. Thus, by complying with the premiums tax reporting and return filing provisions, COMPANY will qualify for exemption from the income and franchise tax under Utah Code Section 59-7-104 pursuant to Utah Code Section 59-7-102(1)©. (See Utah Administrative Rule R865-6F-18 (B) and form, TC 161, Utah Registration for Exemption from Corporate Franchise or Income Tax, item 3.)

2. *Do the federal provision in Title XVIII of the Social Security Act (Title XVIII appears in the United States Code as §§ 1395-1395hhh, subchapter XVIII, chapter 7, title 42), prohibiting the imposition of a state premium tax with respect to PDP sponsors and prescription drug plans, interfere with COMPANY'S exemption under Utah Code Section 59-7-102(1)© from the income and franchise tax under Utah Code Section 59-7-104? The federal provisions, described below, that are relevant to this issue are 42 USCS §§ 1395w-112(g), 1395w-24(g), and 1395w-26(b)(3).*

42 USCS § 1395w-112(g) (also referred to as Section 1860-D12(g) of Title XVIII of the Social Security Act) "Prohibition of State imposition of premium Taxes; relation to State laws" provides:

> The provisions of sections 1854(g) and 1856(b)(3) [42 USCS §§ 1395 w-24(g) and 1395w-26(b)(3)] shall apply with respect to PDP sponsors and prescription drug plans under this part [42 USCS §§ 1395w-101 et seq.] in the same manner as such sections apply to MA organizations and MA plans under part C [42 USCS §§ 1395w-21 et seq.].

42 USCS § 1395w-24(g) (also referred to as Section 1854(g) of Title XVIII of the Social Security Act) "Prohibition of State imposition of premium Taxes" provides:

> No State may impose a premium tax or similar tax with respect to payments to Medicare + Choice organizations under section 1853 [42 USCS § 1395w-23] or premiums paid to such organizations under this part [42 USCS §§ 1395w-21 et seq.].

42 USCS § 1395w-26(b)(3) (also referred to as Section 1856(b)(3) of Title XVIII of the Social Security Act) "Relation to State laws" provides:

> The standards established under this part [42 USCS §§ 1395w-21 et seq.] shall supersede any State law or regulation (other than State licensing laws or State laws relating to plan solvency) with respect to MA plans which are offered by MA organizations under this part [42 USCS §§ 1395w-21 et seq.].

The foregoing operates to prohibit imposition of a state-level insurance premium tax as specified in the above federal law.

Based on the analysis in question 1, an insurer that complies with the insurance premium reporting and return filing provisions of Utah Code, Title 59, Chapter 9 will qualify for exemption from the income and franchise tax under Utah Code Section 59-7-104 pursuant to Utah Code Section 59-7-102(1)© despite having zero premiums tax liability due to application of Utah Code Section 59-9-101(5)(a). As discussed above, an insurer is in effect treated as "otherwise taxed on its insurance premiums" by complying with the Utah insurance premium reporting and filing requirements. Applying this same

reasoning, the federal statues prohibiting imposition of state premium tax on. COMPANY will not prevent application of the state income and franchise tax exemption under Utah Code Section 59-7-102(1)(c) as long as COMPANY complies with the aforementioned Utah insurance premium reporting and return filing provisions.

Summary

In summary, we respectfully request that the Tax Commission rule that Utah Code Section 59-7-102(1) 9c) will apply to COMPANY, thus exempting it from the state's income and franchise tax under Utah Code Section 59-7-104, provided that COMPANY complies with the insurance premium reporting and return filing provisions of Utah Code, Title 59, Chapter 9. We further request that the Tax Commission rule that this income and franchise tax exemption will apply even if COMPANY has zero premiums tax liability due to application of Utah Code Sections 59-9-101(5)(a), or where imposition of the premiums tax is federally prohibited under Title XVIII of the Social Security Act as codified in 42 USCS §§ 1395w-112(g), 1395w-24(g), and 1395w-26(b)(3).

Should you be included to rule to the contrary on this matter, we request the opportunity to meet with you and further discuss the issue. Your assistance in this matter will be very much appreciated.

Sincerely,

TAXPAYER REPRESENTATIVE
COMPANY

Enclosures

RESPONSE LETTER

November 25, 2009

TAXPAYER REPRESENTATIVE
COMPANY
ADDRESS

Re: Private Letter Ruling 08-003

Dear TAXPAYER REPRESENTATIVE,

This letter is in response to your request for tax guidance. This letter ruling is not intended as a statement of broad Tax Commission policy. It is an interpretation and application of the tax law as it relates to the facts presented in your request letter and the assumptions stated in the Analysis portion of this ruling letter. If the facts or assumptions are not correctly described in this letter ruling, please let me know so we can assure a more accurate response to your circumstances.

Facts

COMPANY ("COMPANY") is a domestic insurance company that is legally and commercially domiciled in Utah. Before 2009, COMPANY was an inactive insurer. Beginning on January 1, 2009, COMPANY began providing Medicare Part D prescription drug plans throughout the 50 states and District of Columbia. COMPANY indicates that it is licensed as a life and health insurance company under Utah Code, Title 31A, Chapter 5.

COMPANY is providing prescription drug plans under Medicare Part D as established by the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Pub. L. No. 108-173, 117 Stat. 2066 (2003) (the "2003 Act"). The 2003 Act requires prescription drug plan sponsors to be licensed under state law as a risk-bearing entity, such as an insurer or health maintenance organization, eligible to offer health insurance or health benefits coverage in each state in which the applicant offers a prescription drug plan. COMPANY is currently admitted to write life and/or health insurance in 46 states and the District of Columbia, and has submitted applications to be admitted to write insurance in the remaining four states in which it will offer a prescription drug plan. The prescription drug plans that will be offered by COMPANY are subject to an annual bidding requirement of and regulatory approval by The Federal Centers for Medicare and Medicaid Services.

In its request for a Private Letter Ruling, COMPANY requested advice on two specific questions:

1. *If COMPANY is exempt from the insurance premium tax under Utah Code Section 59-9-101(5)(a), will Utah Code Section 59-7-102(1)(c) apply to COMPANY thus exempting it from income and franchise tax under Utah Code Section 59-7-104?*

2. *Do the federal provision in Title XVIII of the Social Security Act (Title XVIII appears in the United States Code as §§ 1395-1395hhh, subchapter XVIII, chapter 7, title 42), prohibiting the imposition of a state premium tax with respect to PDP sponsors and prescription drug plans, interfere with COMPANY's exemption under Utah Code Section 59-7-102(1)(c) from the income and franchise tax under Utah Code Section 59-7-104? The federal provisions,*

described below, that are relevant to this issue are 42 USCS §§ 1395w-112(g), 1395w-24(g), and 1395w-26(b)(3).

Relevant Authority

Utah Code §59-7-104(1) provides for an income or franchise tax on corporations doing business in Utah:

> Each domestic and foreign corporation, except those exempted under Section 59-7-102, shall pay an annual tax to the state based on its Utah taxable income for the taxable year for the privilege of exercising its corporate franchise or for the privilege of doing business in the state.

Among the exemptions to income or franchise tax in Utah Code §59-7-102 is an exemption for "an insurance company that is otherwise taxed on the insurance company's premiums under Chapter 9, Taxation of Admitted Insurers." Utah Code §59-7-102(1)(c).

Utah Code §59-9-101(1)(a) imposes a premium tax on some, but not all, insurance premiums collected by insurers admitted in the state of Utah:

> Except as provided in subsection (1)(b), 1(d), or (5), every admitted insurer shall pay to the commission on or before March 31 in each year, a tax of 2-1/4% of the total premiums received by it during the preceding calendar year from insurance covering property or risks located in this state.

Federal law, however, prohibits the state from imposing a premiums tax on some types of health insurance. 42 USCS § 1395w-24(g) (also referred to as Section 1854(g) of Title XVIII of the Social Security Act) "Prohibition of State imposition of premium taxes" provides:

> No State may impose a premium tax or similar tax with respect to payments to Medicare + Choice organizations under section 1853 [42 USCS § 1395w-23] or premiums paid to such organizations under this part [42 USCS §§ 1395w-21 et seq.].

In accordance with federal law, Utah Code §59-9-101(5)(a) provides that "insurers licensed under Title 31A, Chapter 5, Domestic Stock and Mutual Insurance Corporations" are "not subject to the premium tax on health care insurance that would otherwise be applicable under" Utah Code §59-9-101(1).

Analysis and Ruling

Because COMPANY has asked two specific questions, the Commission will respond separately to each question:

1. *If COMPANY is exempt from the insurance premium tax under Utah Code Section 59-9-101(5)(a), will Utah Code Section 59-7-102(1)(c) apply to COMPANY thus exempting it from income and franchise tax under Utah Code Section 59-7-104?*

COMPANY indicates that it is an admitted insurer licensed under Title 31A, Chapter 5, Domestic Stock and Mutual Insurance Corporations. This licensure would trigger Utah Code §59-9-101(5)(a), and would provide that COMPANY is "not subject to the premium tax on health care insurance that would otherwise be applicable under" Utah Code §59-9-101(1).

As to an exemption to income or franchise tax, Utah Code §59-7-102(1)(c) requires that to qualify for an exemption, COMPANY would have to be "otherwise taxed on [its] premiums under Chapter 9, Taxation of Admitted Insurers." As used in Utah Code §59-7-102(1)(c), the phrase "otherwise taxed" is subject to two meanings. The phrase could require that to be exempt from income or franchise tax, insurers have to actually pay premium tax. A second possible meaning is that the insurer has to be governed by the Chapter 9 tax on premiums, whether or not any tax is actually due.. Under this second meaning, the insurer would be "otherwise taxed" even if it qualified for exemptions or credits for a particular policy or line of business. [1]

The Commission considers the two possible interpretations of the phrase "otherwise taxed" in light of how each interpretation would function in practice. If "otherwise taxed" requires an actual payment of a premium tax, an insurer writing only Medicare Part D coverage would not be taxed on its premiums. That insurance carrier would have to pay income or franchise tax because it paid no premium tax. A second insurer that wrote the same Medicare Part D coverage as its main business but also wrote one auto policy would be an insurer that was "otherwise taxed" on its premiums because it paid premium tax on the one auto policy. This would free the second insurer from income or franchise taxes. If the second insurer were to fail to write an auto policy for a given year it would then be subject to income or franchise tax for that year. Similarly, dividend deductions in a particular year could reduce the premium tax base to zero. *See* Utah Code §59-7-101(c)(iii). It would be counterintuitive to suppose that a company's qualification for a legislatively authorized deduction to the premium tax would result in the imposition of an income tax on the company receiving the deduction.

If the Commission interprets "otherwise taxed" as coming under a taxation plan on the basis of premiums, admitted insurers would be free from income or franchise tax because they come under Utah's plan to tax admitted insurers whether or not Utah's premium tax plan allows a deduction or exemption for certain specific policies or lines of insurance, i.e., they are "otherwised taxed on the insurance company's premiums under Chapter 9," even though the tax base in any particular year may be zero.

Historically, the Commission has interpreted the phrase "otherwise taxed" in Utah Code §59-7-102(1)(c) to mean admitted insurers that are taxed as part of a state plan to

[1] In addition to the exemptions discussed herein, the tax base may also be reduced in any particular year by premiums returned or credited to policyholders, reinsurance premiums, and certain dividends. See Utah Code §59-7-101(c).

tax those insurers on the basis of premiums. Absent direction to the contrary from the legislature, the Commission has no plans to depart from its previous interpretation which provides that admitted insurers are not subject to income or franchise taxes because they are more properly treated under the insurance premium taxation provisions of the Code.

2. *Do the federal provisions in Title XVIII of the Social Security Act (Title XVIII appears in the United States Code as §§ 1395-1395hhh, subchapter XVIII, chapter 7, title 42), prohibiting the imposition of a state premium tax with respect to PDP sponsors and prescription drug plans, interfere with COMPANY's exemption under Utah Code Section 59-7-102(1)(c) from the income and franchise tax under Utah Code Section 59-7-104? The federal provisions, described below, that are relevant to this issue are 42 USCS §§ 1395w-112(g), 1395w-24(g), and 1395w-26(b)(3).*

The federal provisions cited are a prohibition on the imposition of premium taxes on specific lines of insurance. For the reasons stated above, the exemption of these premiums does not result in an admitted insurer, such as COMPANY, being subject to the corporate income tax provisions of Utah law. It makes no difference whether the exemption for these premiums is the result of federal law or of a state law implementing the federal law.

Although federal preemptions must generally be explicit, and there is no explicit preemption of state income tax on insurance providers, we note that our current interpretation of Utah law is consistent with the federal policy goal of reducing tax on certain insurance premiums. It appears that our state legislature shares this policy goal. If the legislature had intended to subject health insurance companies to the corporate income tax, it could surely have done so in a less ambiguous manner.

Conclusion

The Commission, by a 3-1 vote[2] does not plan to change from its interpretation of Utah law, which provides that admitted insurers that are governed by Title 59, Chapter 9, are not subject to income or franchise tax, even though the Chapter 9 tax base may be zero in any particular year. An admitted insurer such as COMPANY is not subject to income or franchise tax notwithstanding that Utah's premium tax plans do not require payment for some policies. This ruling, of course, is based on current law and could be changed by subsequent legislative action or judicial interpretation.

For the Commission,

R. Bruce Johnson
Commissioner

[2] Commissioner Marc Johnson believes the term "otherwise taxed" means that the legislature intended for admitted insurers to be exempt from an income or franchise tax only if they actually pay the premiums tax. He would have, however, made this ruling prospective.