

**FORC QUARTERLY JOURNAL  
OF  
INSURANCE LAW AND REGULATION**

**Summer 1998 June 20, 1998 Vol. X, Edition II**

**PENNSYLVANIA LIFE AND HEALTH INSURANCE GUARANTY ASSOCIATION QUALIFIED ANNUITY PREMIUM ASSESSMENT OFFSET AGAINST GROSS PREMIUMS TAX,**

S. Walter Foulkrod, III, Esq.  
Andrew H. Foulkrod, Esq.  
(717) 541-0400

It is the statutory right of a "member insurer"<sup>1</sup> to offset against its Gross Premiums Tax<sup>2</sup> liability a proportionate part of assessments<sup>3</sup> paid to the Pennsylvania Life and Health Insurance Guaranty Association ("PLHIGA"). 40 P.S. 991.1711. This proportionate part offset is determined according to a fraction:

Of which the denominator is the total premiums received by the company during the calendar year immediately preceding the year in which the assessment is paid and the numerator is that portion of the premiums received during such year on account of policies of life or health and accident insurance in which the premium rates are guaranteed during the continuance of the respective policies without a right exercisable by the company to increase said premium rates.<sup>4</sup>

Currently before the Commonwealth Court of Pennsylvania<sup>5</sup> is the issue of whether the Pennsylvania Department of Revenue ("Revenue") may properly exclude qualified<sup>6</sup> annuity premiums from the numerator of the proportionate part offset.

***The Tax***

Every insurance company transacting business in the Commonwealth is subject to a tax at the rate of two per cent of the gross premiums received from business done within the Commonwealth during each calendar year.<sup>7</sup> From the latter half of tax year 1991 through tax year 1995 ("tax period") member insurers were subject to the Gross Premiums Tax on annuity considerations. 72 P.S. 7902. During the tax period, "annuity consideration" was defined as "all sums received as consideration for annuity contracts," specifically excluding "sums received in connection with the funding of a pension qualified or exempt." 72 P.S. 7901.<sup>8</sup> Accordingly, qualified annuities were not subject to the Gross Premiums Tax.

***The Assessment***

Member insurers are assessed, separately for each of life insurance, annuity and health insurance accounts, for the purpose of providing the funds necessary to carry out the powers and duties of the association.<sup>9</sup> 40 P.S. 991.1707. The PLHIGA Act specifically and expressly mandates that PLHIGA maintain, as subaccounts to the life insurance and annuity account, a life insurance account, an annuity account and an "unallocated annuity account which shall include contracts qualified under section 403(b) of the Internal Revenue Code of 1986." 40 P.S. 991.1704. Accordingly, member insurers are assessed separately for qualified and nonqualified annuity accounts.

***The Offset***

Section 19 of the PLHIGA Act, added on December 18, 1992, provides that a member insurer may offset against its Gross Premiums Tax liability a proportionate part of assessments to the extent of 20% of the amount of such assessment for each of the five calendar years following the year in which such assessment was paid.<sup>10</sup> The proportionate part offset is determined according to a fraction, the denominator of which is the total premiums received by the company during the calendar year

according to a fraction, the denominator of which is the total premiums received by the company during the calendar year immediately preceding the year in which the assessment is paid and the numerator of which is that portion of the premiums received during such year on account of policies of life or health and accident insurance in which the premium rates are guaranteed during the continuance of the respective policies without a right exercisable by the company to increase said premium rates.<sup>11</sup> While the legislature specifically and expressly provided a formula to determine the proportionate part offset for policies of life or health and accident insurance, it apparently failed to expressly provide a formula for annuity contracts.<sup>12</sup>

### ***Revenue's Policy Determination***

Revenue's Bureau of Corporation Taxes has issued Corporation Tax Bulletin Number 95, Rev. November 1995 ("Tax Bulletin 95"), which provides, in pertinent part, as follows:

The [PHLIGA] Act provides only a proportionate part for policies or contracts of life or health and accident insurance. No proportionate part is specified for assessments on annuities, however. Based solely on policy, the Department of Revenue will permit a credit for a proportionate part of assessments on annuities [for the tax period]. The proportionate part of an assessment which may be offset is determined by a fraction consisting of:

**Numerator:** That portion of the Pennsylvania premiums and annuity considerations received on account of policies or contracts of life or health and accident insurance or annuities in which the premium rates are guaranteed during the continuance of the respective policies. All such policies or contracts . . . must be issued without a right exercisable by the member company to increase said premium rates.

**Denominator:** The total amount of the Pennsylvania premiums and annuity considerations received on policies or contracts by the member company . . .

The above fraction must be determined for **each type** of assessment (i.e. Life Insurance, Accident & Health and Annuity).

This Bureau has determined that the following are included in the above numerator and that PLHIGA assessments paid on the following policies/contracts qualify for the tax credit:

**\*\* Individual (Nonqualified) Annuities**

**\*\* Annuities which are taxed** under Section 902 of the Act of March 4, 1971, known as the Tax Reform Code [72 P.S. 7902].

[Underline supplied]. Accordingly, Revenue has made a policy determination that annuity contracts be included in the proportionate part offset along with life and accident & health insurance; to all applying the statutory requirement that the rates be guaranteed.<sup>13</sup> However, Revenue has also made a policy determination to exclude from the numerator of the proportionate part fraction qualified annuities (annuities which are not subject to the Gross Premiums Tax).

### ***Analysis***

In order to be included in the numerator of the proportionate part fraction, the statute requires only that the premium rates be guaranteed. Qualified annuities satisfy the statutory requirement where the insurer is without the right to increase premium rates during the term of the annuity.

It is patently obvious from Tax Bulletin 95 that Revenue's policy determination to exclude qualified annuity premiums from the numerator of the proportionality fraction is based solely on the fact that qualified annuity premiums are not subject to the Gross Premiums Tax. However, there is no statutory or other requirement that premiums offset against the Gross Premiums Tax be subject to the tax. In fact, prior to offset, there is no relationship between the assessment and the tax. The assessment

Tax be subject to the tax. In fact, prior to offset, there is no relationship between the assessment and the tax. The assessment is not a tax, but a fee assessed for the purpose of providing the funds necessary to pay covered claims of impaired and insolvent insurers. 40 P.S. 991.1706, 991.1707. Accordingly, the logic that "the state has already taxed the life and health insurance premiums once by the assessment of the Association and will not tax them again by the premium tax" is flawed. See *General American Life Insurance Company v. Director of Revenue and Director of Insurance*, 1992 WL 259378 (Mo.Admin.Hrg.Com.) (1992) (attached hereto as Exhibit "6").

Importantly, the legislature authorized as an offset against premium tax liability a proportionate part of total assessments paid.<sup>14</sup> Had the legislature intended to limit offset to a proportionate part of assessments paid on behalf of accounts subject to the tax, it would have done so expressly.

### **Conclusion**

Revenue's policy determination that qualified annuity premiums are excluded from the proportionate part offset against Gross Premiums Tax liability because they are not subject to the Gross Premiums Tax should be overturned by the Commonwealth Court for the following reasons:

Qualified annuities satisfy the statutory prerequisite to inclusion in the numerator of the proportionate part fraction, that the premium rates be guaranteed, where the insurer is without the right exercisable to increase premium rates during the term of the annuity;

2. There is no statutory or other requirement that premiums offset against the Gross Premiums Tax be subject to the tax;

The assessment is not a tax, but a fee assessed for the purpose of providing the funds necessary to pay covered claims of impaired and insolvent insurers (40 P.S. 991.1706, 991.1707);

4. Prior to offset, there is no relationship between the assessment and the tax;

5. Had the legislature intended to limit offset to a proportionate part of assessments paid on behalf of accounts subject to the tax, it would have done so expressly. Instead, it specifically and expressly authorized as an offset against premium tax liability a proportionate part of total assessments paid.

### **Endnotes**

1. A "member insurer" is any insurer licensed or which holds a certificate of authority to transact in the Commonwealth of Pennsylvania any kind of insurance for which coverage is provided under section 1703 and includes any insurer whose license or certificate of authority in the Commonwealth may have been suspended, revoked, not renewed or voluntarily withdrawn. The term does not include any of the following: (1) a nonprofit hospital or medical service organization; (2) a health maintenance organization; (3) a fraternal benefit society; (4) a mandatory State pooling plan; (5) a mutual assessment company or any entity that operates on an assessment basis; (6) an insurance exchange; (7) any entity similar to any of the above. 40 P.S. 991.1702; Act of May 17, 1921, P.L. 682, No. 284, art. XVII, 1711, added Dec. 18, 1992, P.L. 1519, No. 178, 19, imd. effective ("PLHIGA Act").

2 72 P.S. 7902; Act of March 4, 1971, P.L. 6, No. 2 (hereinafter referred to as "TRC"), art. IX, 902 (amended to include "annuity considerations" by the Act of August 4, 1991, P.L. 97, No. 22, 27, imd. effective and retroactive to annuity considerations received after June 30, 1991; amended to delete "annuity considerations" by the Act of June 30, 1995, P.L. 139, No. 21, 11, effective July 1, 1995 applicable to the tax year beginning January 1, 1996 and to each tax year thereafter).

3. 40 P.S. 991.1707.

4. 40 P.S. 991.1711(b).
5. The Commonwealth Court of Pennsylvania ("Commonwealth Court") has jurisdiction over appeals from determinations made by the Board of Finance and Revenue by reason of 42 Pa.C.S.A. 763; Act of July 9, 1976, P.L. 586, No. 142, 2, as amended; and Pa.R.A.P. No. 1571.
6. Annuities not subject to the Gross Premiums Tax. TRC, 902 (72 P.S. 7902).
7. 72 P.S. 7902.
8. TRC, art. IX, 901 (amended to add the definition of "annuity consideration" by the Act of August 4, 1991, P.L. 97, No. 22, 43(6), imd. effective and retroactive to annuity considerations received after June 30, 1991; amended to delete the definition of "annuity consideration" by the Act of June 30, 1995, P.L. 139, No. 21, 26(5), effective July 1, 1995 applicable to the tax year beginning January 1, 1996 and to each tax year thereafter).
9. The purpose of PLHIGA is to pay covered claims of impaired and insolvent insurers. 40 P.S. 991.1706.
10. 40 P.S. 991.1711(a).
11. 40 P.S. 991.1711(b).
12. According to Mr. Charles Fisher at Revenue, annuity contracts did not exist when the law regarding offset was written.
13. A premium rate is "guaranteed" if the insurer is without a right exercisable to increase said premium rates during the continuance of the policy.
14. *See* 40 P.S. 991.1711(a).