Declaratory Ruling 90-10919-M

Michigan surplus lines premium tax -- liability of group self-insurance basis

March 23, 1990

I. BACKGROUND

A. The Requests for a Declaratory Ruling

The Middle Cities Risk Management Trust and the Metropolitan Association for Improved School Legislation Risk Management Trust (hereinafter Applicants) each submitted a formal request that the acting Commissioner of Insurance declare that it is exempt from the tax imposed by the Surplus Lines Insurance Act, 1980 PA 341, as amended, MCLA 500.1901 et seq; MSA 24.11901 et seq. The Middle Cities Risk Management Trust request reads:

> Is the Middle Cities Risk Management Trust liable for payment of the Michigan Surplus Lines Premium Tax on insurance premiums paid by the Middle Cities Risk Management Trust for excess of insurance coverage?

The Metropolitan Association for Improved School Legislation Risk Management Trust request reads:

> Do the provisions of 1982 PA 138 exempt the Metropolitan Association for Improved School Legislation Joint Risk Management Trust from the payment of the Michigan Surplus Lines Premium Tax on insurance premiums paid by the Trust for excess insurance coverage?

The statutes relevant to the requests are the Surplus Lines Insurance Act, *supra*, and 1982 PA 138, as amended. This declaratory ruling is limited to the facts presented by the Applicants' declaratory ruling requests and the statutes they identified in their requests. 1985 AACS, R 500.1043(2).

B. Review of the Facts

Applicants state that they are municipal risk pools formed under authority of 1982 PA 138 by various school districts. In each case, the pool assumes liability for coverage for its members up to an established limit. Applicants purchase excess insurance to provide coverage above their liability limits. Some of the excess insurance coverage is purchased from surplus lines insurers. Surplus lines insurers are insurers not authorized to do business in Michigan.

C. The Surplus Lines Insurance Act

The Surplus Lines Insurance Act, *supra*, regulates surplus lines insurance. "Surplus lines insurance" is defined as:

> . . . insurance in this state procured from or continued or renewed with an unauthorized insurer and includes all of the following, whether effected by mail or otherwise.
>
> (i) Insurance for which applications are solicited from persons resident or located in this state.
>
> (ii) Insurance for which contracts of insurance are issued or delivered to persons resident or located in this state.
>
> (iii) Insurance which is procured through negotiations or by an application occurring in whole or in part in this state or made within or from within this state.
>
> (iv) Insurance for which premiums, in whole or in part, are remitted directly or indirectly within or from within this state. MCLA 500.1903(1)(d); MSA 24.11903(1)(d).

An unauthorized insurer is an insurer which does not have a certificate of authority issued by the commissioner authorizing it to transact insurance in this state. MCLA 500.108; MSA 24.1108.

The Surplus Lines Insurance Act requires that persons who solicit and bind surplus lines coverage or who otherwise act as agent or broker in surplus lines transactions must be licensed under the Act. MCLA 500.1905; MSA 24.11905.

Surplus lines insurance is subject to a 2% premium tax. If a surplus lines policy is purchased through an agent or broker licensed under the Act, the licensee must collect the tax from the insured person and remit the tax with a report to the commissioner semi-annually. MCLA 500.1905(3)(e) and 1950(b); MSA 24.11905(3)(e) and 11950(b). If the surplus lines policy is not obtained through an agent or broker licensed under the Act, then the individual or business which procured the insurance must itself make a report and pay the tax to the commissioner within 30 days after the insurance is procured. MCLA 500.1951; MSA 24.11951.

The tax is not imposed on the surplus lines insurance company. It is imposed, instead, upon the insured person. Failure to pay the tax subjects the insured person to a civil fine of not more than $1,000.00 plus accrued interest. MCLA 500.1950(b); MSA 24.11950(b).

D. 1982 PA 138

In 1982 the legislature amended Michigan law to expressly authorize municipalities to enter into contracts with other municipalities to form group self-insurance pools. The legislation was passed in response to the tremendous difficulty that municipalities were experiencing in obtaining affordable insurance coverage.

> Some municipalities have been denied renewal of their insurance coverage regardless, apparently, of 'solid' claim and loss records. Others have been able to retain their existing coverage, but only at the price of paying considerably higher premiums (some municipalities have faced increases of 300-500% over only two or three years). Municipal insurance coverage has also been reduced because some insurance companies have refused to insure all but the least risky functions covered. Analysis of SB 348 (as enrolled, Public Act 138 of 1982) Senate Analysis Section (May 17, 1982) p 1.

1982 PA 138 authorizes municipalities, including school districts, to form self-insurance pools. It was believed that these pools would allow their members to save money over traditional insurance while also allowing improved risk management programs and the collection of data and statistics necessary to accurately determine the costs and liability exposures of each municipality. *Id*. The pools function like insurance companies. The liability of each of the members is shifted to the pool established by all the members in much the same way that liability is shifted to an insurance company in a traditional insurance policy.

II. ANALYSIS

A. 1982 PA 138 Does Not Broadly Exempt Group Self-Insurance Pools From The Insurance Code. Instead, It Declares That Group Self-Insurance Pools Are Not Insurance Companies And Are Not Engaged In The Insurance Business.

Applicants cite MCLA 124.6; MSA 5.4085(6.6) in support of their claim that they are exempt from the tax. The Metropolitan Association for Improved School Legislation Risk Management Trust characterizes this section as "a specific and broad exception for municipal pools from regulation and taxation under the insurance code." Request for Declaratory Ruling, p 5. The language of that section does not support this broad construction.

MCLA 124.6; MSA 5.4085(6.6) reads as follows:

> Any group self-insurance pool organized pursuant to section 5 *is not an insurance company or insurer under the laws of this state*. The development, administration, and provision of group self-insurance programs and coverages authorized by this act by the governing authority created to administer the pool pursuant to section 7(c) *does not constitute doing an insurance business*. (Emphasis added.)

The legislature did not broadly exempt group self-insurance pools from the Insurance Code. Instead, it declared that the pools are not insurers, and when administering their programs are not engaged in the insurance business. The distinction is critical here. While this language may in effect exempt group self-insurance pools from complying with regulations imposed upon insurance companies, it does not exempt them from regulations imposed broadly upon all persons.

The tax imposed by the Surplus Lines Insurance Act is not imposed upon insurance companies. On the contrary, it is imposed broadly upon any person who purchases surplus lines coverage. If the surplus lines coverage is purchased through a surplus lines licensee, then the licensee collects the tax from the insured and forwards it to the Commissioner. MCLA 500.1905(3)(e) and 1950(b); MSA 24.11905(3)(b) and 11950(b). If the surplus lines coverage is purchased directly, then the insured himself is required to directly pay the tax to the Commissioner. MCLA 500.1951; MSA 24.11951. In either case, the tax is not imposed upon the surplus lines insurer, it is imposed upon the entity purchasing the surplus lines insurance.

B. Under Michigan Law, Exemptions From Taxation Are Not Presumed. A Person Asserting A Tax Exemption Must Show That The Legislature Clearly And Unambiguously Intended The Exemption.

It is a long-standing rule in Michigan that exemption from taxation is never presumed. The burden falls upon the person asserting the exemption to show that the legislature intended the exemption in clear and unambiguous terms.

In *Detroit* v *Detroit Commercial College*, 322 Mich 142, 148 (1948), the Michigan Supreme Court quoted with approval the following statement of the rule in Michigan.

> 'An intention of the part of the legislature to grant an exemption from the taxing power of the State will never be implied from language which will admit of any other reasonable construction. Such an intention must be expressed in clear and unmistakable terms, or must appear by necessary implication from the language used, for it is a well- settled principle that, when a specific privilege or exemption is claimed under a statute . . . it is to be construed strictly against the property owner and in favor of the public. *This principle applies with peculiar force to a claim of exemption from taxation. Exemptions are never presumed, the burden is on a claimant to establish clearly his right to exemption, and an alleged grant of exemption will be strictly construed and cannot be made out by inference or implication but must be beyond reasonable doubt . . . '* (Emphasis added.)

Quoting from 2 Cooley on Taxation (4th Ed.), p 1404, s 672.

The Court continues to follow this rule. *See, e.g. Ladies Literary Club* v *Grand Rapids*, 409 Mich 748, 754 (1980), and *Town & Country Dodge* v *Dept of Treasury*, 420 Mich 226, 242-243 (1984).

C. Applicants Are Not Exempt From The Tax Imposed By The Surplus Lines Insurance Act.

It is clear that the legislature did not exempt group self-insurance pools from the tax imposed upon all persons obtaining surplus lines insurance coverage. The statute merely states that group self-insurance pools are not insurance companies. The surplus lines insurance tax, however, is not a tax on insurance companies. It in a tax upon anyone who purchases surplus lines insurance coverage.

As the Middle Cities Risk Management Trust points out in its request, the legislature has seen fit to directly exempt municipalities from various state taxes. For example, MCLA 205.54(5); MSA 7.524(5), exempts proceeds from sales to " . . . this state or its departments and institutions *and any of its political subdivisions*" from the sales tax. Similarly, MCLA 205.94(h); MSA 7.555(4)(h) exempts property or services sold to, *inter alia*, " . . . this state, a department or institution of this state, *or a political subdivision of this state*" from the use tax. Had the legislature intended to exempt group self-insurance pools from the surplus lines insurance tax, it would have done so directly.

III. FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. The Middle Cities Risk Management Trust and the Metropolitan Association for Improved School Legislation Risk Management Trust are group self-insurance pools established under 1982 PA 138, as amended.

2. The Middle Cities Risk Management Trust and the Metropolitan Association for Improved School Legislation Risk Management Trust purchase excess insurance from, *inter alia*, insurance companies not authorized to conduct business in this state.

3. Insurance purchased from unauthorized insurers constitutes surplus lines insurance. MCLA 500.1903(1)(d); MSA 24.11903(1)(d) and MCLA 500.108; MSA 24.1108.

4. It is a long-standing rule in Michigan that exemption from taxation is never presumed. The burden falls upon the person asserting the exemption to show that the legislature intended the exemption in clear and unambiguous terms. *E.g., Detroit* v. *Detroit Commercial College*, 322 Mich 142, 148 (1948), and *Ladies Literary Club* v *Grand Rapids*, 409 Mich 748, 754 (1980). Exemptions are not favored and statutory exemptions from taxations are construed strictly against the taxpayer. *Town & Country Dodge* v. *Dept of Treasury*, 420 Mich 226, 242-243 (1984).

5. The legislature did not broadly exempt group self-insurance pools from the Insurance Code. Instead, it declared that the pools are not insurers, and when

administering their programs are not engaged in the insurance business. MCLA 124.6; MSA 5.4085(6.6).

6. The tax imposed by the Surplus Lines Insurance Act is not imposed upon insurance companies. It is imposed, instead, broadly upon all persons who purchase surplus lines insurance. The tax is not imposed upon the surplus lines insurance company providing the coverage.

7. Group self-insurance pools are not exempt from the tax imposed by the Surplus Lines Insurance Act.

IV. RULING

For the foregoing reasons, it is my ruling that neither the Middle Cities Risk Management Trust nor the Metropolitan Association for Improved School Legislation Risk Management Trust are exempt from the tax imposed by the Surplus Lines Insurance Act, *supra*.

This ruling is limited to the facts which were presented by the Middle Cities Risk Management Trust and the Metropolitan Association for Improved School Legislation Risk Management Trust and the statutes they identified in their requests. R 500.1043(2).

Dhiraj N. Shah
Acting Commissioner of Insurance