

**CALIFORNIA STATE BOARD OF EQUALIZATION**  
**APPEALS DIVISION BOARD HEARING SUMMARY**

3	In the Matter of the Claim for Refund	)	
4	Under the Tax on Insurers Law of:	)	
5	TRUCK INSURANCE EXCHANGE	)	Account Number IT STF 34-001199
6	Claimant	)	Case ID 240627
		)	Los Angeles, Los Angeles County

7

8 Type of Business: Interinsurance Exchange Company

9 Claim period: 01/01/00 – 12/31/00

10	<u>Item</u>	<u>Claimed Refund</u>
11	Tax paid on gross premiums	\$1,057,500

12 Claimant filed a claim for refund for tax it had paid on gross premiums, arguing that its  
13 payment of \$45,000,000 to subscribers in the year 2000 was deductible from gross premiums.

14 This matter was scheduled for Board hearing in February 2015, but was postponed at  
15 claimant’s request due to a scheduling conflict.

16 This appeal involves an amount in controversy that is \$500,000 or more and thus is covered by  
17 Revenue and Taxation Code section 40, as explained below.

**UNRESOLVED ISSUE**

18

19 **Issue:** Whether the claim for refund should be granted because the subject payment was  
20 deductible from gross premiums as a return of premiums or as a return of savings to subscribers. We  
21 conclude that the subject payment was not deductible from gross premiums subject to tax and find that  
22 the claim for refund should be denied.

23 The California Constitution imposes a tax on insurers based on the insurer’s “gross premiums,  
24 less return premiums, received in such year by such insurer upon its business done in this state....”  
25 (Cal. Const. Art. XIII, sec (c).) In the most basic terms, the issue in this matter is whether payments of  
26 \$45,000,000 by claimant to its subscribers (its insured members) represented a reduction to the amount  
27 of gross premiums subject to tax.

1 Claimant provided insurance to members of the California Hospital Association (CHA). The  
2 policy period relevant to this appeal is January 1, 1973, through December 31, 1984, at the end of  
3 which the policy terminated. Claimant and CHA also entered into an agreement entitled "Hospital  
4 Professional Liability Premium Determination and Disposition Agreement" (PDA), under which  
5 claimant was required to apply certain surplus amounts to reduce premiums payable by the subscribers  
6 during the policy period and then to pay certain surplus amounts annually to the covered subscribers,  
7 beginning on June 1, 1990, and continuing through June 1, 2000. In May 1994, after four of the eleven  
8 required annual payments presumably had been made, a lawsuit was filed on behalf of the subscribers  
9 alleging claimant had not paid all amounts it was required to have paid pursuant to the PDA.

10 After the filing of the suit, claimant and the subscribers entered into an agreement under which  
11 claimant made a payment of \$5,623,231 to the subscribers, which the subscribers were required to  
12 return if they did not prevail in the lawsuit. The parties thereafter entered into an agreement to settle  
13 the suit under which the subscribers retained the \$5,623,231 payment previously made by claimant and  
14 received an additional payment of \$45,000,000 in 2000.

15 In August 2003, claimant filed with the Department of Insurance (DOI) a claim for refund of  
16 \$1,057,500 in tax based on claimant's assertion that it overpaid its insurance tax for 2000 because it  
17 returned premiums of \$45,000,000 during that year for which it had not taken a deduction from its  
18 gross receipts as authorized by Revenue and Taxation Code section 12221.

19 By letter dated March 29, 2005, DOI advised the Board and claimant that, based on its review,  
20 it found the claim for refund should be granted. However, the letter did not describe the nature of  
21 DOI's review. The Board's Property and Special Taxes Department (Department) reviewed the claim  
22 and found that it should be denied because the available information did not disclose what portion, if  
23 any, of the settlement amount was paid from tax-paid premiums. Further, the Department has found  
24 that the \$45,000,000 payment was comprised substantially or entirely of investment income earned on  
25 premiums rather than the tax-paid premiums themselves. Accordingly, the Department concluded that  
26 the payment does not qualify as return premiums under section 12221.

27 Claimant then argued that, even if the \$45,000,000 payment does not qualify as return  
28 premiums under section 12221, the claimed refund should still be granted because claimant, as an

1 interinsurance exchange, is entitled to rely on Insurance Code section 1530, which allows an exchange  
2 to take a deduction in computing its gross premiums for amounts returned to subscribers or credited to  
3 their accounts as savings.

4 To reiterate, the constitutionally established measure of tax (an insurer's gross premiums less  
5 return premiums (Cal. Cost. Art. XIII, sec (c)) is restated in Revenue and Taxation Code section  
6 12221. In section 12221, there is a proviso that "[g]ross premiums of reciprocal or interinsurance  
7 exchanges shall be determined as provided in Section 1530 of the Insurance Code." As relevant here,  
8 section 1530 provides that, "gross premiums, as applied to reciprocal or interinsurance exchanges,  
9 includes all sums paid by subscribers in this state by reason of the insurance exchange, whether termed  
10 premium deposit, membership fee, or otherwise, after deducting therefrom premium deposit returns or  
11 cancellations, and all amounts returned to subscribers or credited to their accounts as savings...."

12 Claimant argues that payments made pursuant to the PDA were deductible from gross  
13 premiums as return premiums under Revenue and Taxation Code section 12221 or deductible to  
14 compute gross premiums as savings returned to subscribers under Insurance Code section 1530. Since  
15 claimant regards the \$45,000,000 settlement payment as one made pursuant to the PDA, it claims a  
16 refund of the insurance tax it paid because it did not take a deduction with respect to that payment.  
17 That is, underlying the claim for refund is the assertion that the disputed \$45,000,000 payment should  
18 be regarded as a payment required by the PDA. However, there is no dispute that the payment was  
19 actually made pursuant to the settlement agreement. We must therefore determine whether the  
20 payment can be properly regarded as one made pursuant to the PDA in addition to being a business  
21 expense to settle litigation.

22 Although there are many claims made in the lawsuit, we find that the complaint actually seeks  
23 satisfaction for a single wrong, supported by numerous different theories for recovery. The parties to  
24 the lawsuit eventually entered into a settlement agreement, and it is undisputed that the \$45,000,000  
25 payment at issue in this appeal was paid as part of that settlement. The settlement agreement does not  
26 expressly state the parties' agreement that the payment was intended to be entirely for the purpose of  
27 compensating subscribers for amounts they believed were due under the PDA, and the agreement  
28 certainly touches on more than that one point. To the extent that any portion of the settlement payment

1 was intended to cover fees of attorneys and costs of litigation, such amounts could not qualify for  
2 deduction under any theory.

3       Based on our review of the evidence, we believe that at least a portion of the settlement  
4 payment is properly regarded as having been intended to cover amounts the subscribers believed were  
5 due under the PDA. However, claimant has not established what specific portion of the payment  
6 should be so regarded and certainly has not established that the entire payment should be so regarded.  
7 Nevertheless, for purposes of the remainder of this analysis, we will treat the settlement payment as a  
8 payment required by the PDA, with the caveat that, if this aspect of the appeal were to become relevant  
9 to the ultimate result, claimant has the burden of specifically establishing what portion of the  
10 settlement payment should be regarded as a payment made pursuant to the PDA.

11       We first consider whether the payment of \$45,000,000 qualifies as a return premium. Based on  
12 a review of the statutes and relevant court decisions, we find that the \$45,000,000 payment, made more  
13 than 15 years after the end of the policy term, was not a return of premiums because of a cancellation  
14 of the policy before the risk had attached, or because the policy was otherwise voided, nor does the  
15 payment represent a return of premium because the policy had been issued because of a mistake of fact  
16 or law or procured through fraud. Indeed, we find there is no basis whatsoever for asserting that the  
17 amount payable as surplus pursuant to the PDA was unearned premiums which were in excess of the  
18 premium claimant was lawfully entitled to claim.

19       Further, even if there were some basis to consider the disputed payment as eligible to be  
20 considered return premiums, claimant has not shown that any of the \$45,000,000 payment was actually  
21 return of premiums. Rather than tracing any portion of the payment to actual premiums paid by its  
22 subscribers, claimant notes that the total amounts paid to subscribers pursuant to the PDA after  
23 termination of the policy did not exceed the total amount of premiums paid. This argument has no  
24 basis whatsoever.

25       The payments required by the PDA were made pursuant to the termination clause of the PDA  
26 and were distributions of the “program surplus,” which were the amounts held in the “dividend reserve  
27 account.” It appears from the description of that account that it was primarily composed of investment  
28

1 earnings. Consequently, in absence of evidence to the contrary, we find it reasonable to regard  
2 payments required by the PDA to have come substantially or completely from investment earnings.

3 In sum, we conclude that the \$45,000,000 payment cannot lawfully qualify as return premiums  
4 regardless of its source, and even if the payment could theoretically qualify, that claimant has failed to  
5 establish that the source of any portion of that payment was premiums. We therefore conclude that,  
6 based on claimant's original theory for its claim, that the payment represents return premiums, the  
7 claim must be denied.

8 In light of this conclusion, we address whether a different result is required by Insurance Code  
9 section 1530. The same measure of tax applicable to any other insurer, gross premiums less return  
10 premiums, applies to the interinsurance exchanges. However, for such exchanges we must look to  
11 section 1530 for the specific definition of gross premiums, which is "all sums paid by subscribers in  
12 this state by reason of the insurance exchange, whether termed premium deposit, membership fee, or  
13 otherwise, after deducting therefrom premium deposit returns or cancellations, and all amounts  
14 returned to subscribers or credited to their accounts as savings...." The wording of section 1530 seems  
15 to take into account that the terminology used for interinsurance exchanges may be different than for  
16 other insurers in its attempt to apply the constitutional measure of tax to such exchanges. For example,  
17 most insurers receive amounts called premiums as consideration for the insurance they provide while  
18 an exchange may receive such amounts in the form of premium deposits or membership fees. It  
19 appears that section 1530 is simply making clear that an amount paid for insurance is part of an  
20 exchange's gross premiums, whatever the amount is called. Likewise, the reference to premium  
21 deposit returns or cancellations appears to be specifically describing what would otherwise be called  
22 premiums. Thus, looking to the words alone, section 1530 appears to restate the constitutional  
23 measure of tax, gross premiums less return premiums, in the context of interinsurance exchanges, and  
24 thus presents no issue as to whether the provision incorrectly changes the constitutional measure of tax.  
25 However, once the gross premiums of an interinsurance exchange are determined, we must return to  
26 Revenue and Taxation Code section 12221 to complete the calculation of the taxable measure, that is,  
27 to allow a deduction from those gross premiums for return premiums. We must make the effort to  
28 harmonize section 1530 with the other applicable authorities, most importantly the California



