STATE BOARD OF EQUALIZATION
TAX ON INSURERS APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Petition for Redetermination Under the Tax on Insurers Law of: CK SPECIALTY INSURANCE ASSOCIATES, INC. Petitioner	Account Number IB STF 60-000548 Case ID 605192 San Jose, Santa Clara County

Type of Business: Surplus lines broker

Audit period: 01/01/07 – 12/31/10

Item	Disputed Amount
Inspection fees and policy fees	$1,934,531

Tax as determined and protested	$ 58,035.94
Interest through 04/01/16	45,089.92
Total tax and interest	$103,125.86
Monthly interest beginning 04/02/16	$580.36

UNRESOLVED ISSUE

Issue: Whether the inspection fees and policy fees were part of petitioner's taxable gross premiums. We find that they were.

Petitioner is a surplus line broker licensed by the Department of Insurance (DOI).[1] According to petitioner, its primary business contacts are with retail insurance brokers, and those retail insurance brokers deal directly with the potential insurance customers. However, petitioner occasionally deals directly with insureds, without involvement of any retail insurance brokers.

In its audit, DOI found that petitioner had failed to include charges identified as inspection fees and policy fees as part of its reported gross premiums. DOI concluded that these fees were taxable gross premiums because the fees were part of the cost of insurance to the insureds. Therefore, DOI

[1] A surplus line broker is a person who arranges insurance for California insureds with insurers who are not licensed to do business in California (nonadmitted insurers).

proposed in writing to the Board that a Notice of Deficiency Assessment be issued to petitioner, and the Board issued that notice on February 6, 2012. Petitioner filed a timely petition for redetermination.

Petitioner principally placed insurance with two nonadmitted insurers, Colony Insurance Company (Colony) and Certain Underwriters at Lloyd's, London (Lloyd's), although it did place insurance with other nonadmitted insurers. Petitioner has provided a contract it executed with Colony and a contract with Lloyd's. Petitioner received a commission when placing insurance with nonadmitted insurers. When a policy was purchased, petitioner sent the broker an invoice showing what we understand to be the total amount charged or to be charged by the broker to the insured for the insurance, and also the amount due to petitioner from the broker, that is, the amount due from the insured less the broker's portion of the commission paid by the insurer. Petitioner has provided examples of the invoices it issued. The invoices itemize the charges comprising the total amount due from the insured and from the retail insurance broker. Each has an itemized charged for "premium" which is the amount specified by the insurer or under petitioner's contract with the insurer for the insurance policy, and the amount of the retail insurance broker's commission, with the net amount due from the broker for that item. The invoices each have an itemized charge for "state tax," which is essentially reimbursement for the amount petitioner has computed as the surplus line tax it owes with respect to premiums for that policy.[2] Finally, the invoices have some combination of three additional fees, a "broker fee," an "inspection fee," and a "policy fee" (no invoice reflects more than two such fees). Petitioner did not regard any of these fees as part of its taxable gross premiums.

DOI asserts that the inspection fees and the policy fees were part of petitioner's taxable gross premiums because such fees were part of the cost of insurance to the insureds. Petitioner argues that these fees were broker fees that the insureds paid to compensate petitioner for services it provided to the insureds. Since DOI accepts that broker fees were not part of taxable gross premiums, petitioner asserts that the inspection fees and policy fees are also excludable from its taxable gross premiums.

---

[2] The invoices also have an itemized charge for "stamp fee," which is reimbursement for a fee imposed on petitioner to fund the Surplus Line Association of California. Petitioner did not regard the stamp fee as part of its taxable premiums, and DOI has not asserted that such amounts are part of its taxable gross premiums. DOI also has not asserted that amounts petitioner charged as broker fees were part of petitioner's taxable gross premiums.

STATE BOARD OF EQUALIZATION
TAX ON INSURERS APPEAL

There is no dispute that the inspection fees and the policy fees were neither required by nor remitted to the insurers. Also, petitioner has acknowledged that most insurance certificates it issued on behalf of insurers contain a column entitled "Premium" which lists the amount specified by the insurer or under petitioner's contract with the insurer for the insurance, an amount for tax, an amount for the stamp fee, and any additional fees it charged, with the sum characterized as "Premium Total" or "Total Policy Premium." However, petitioner argues that this computation was done as a convenience for the insureds, who likely interpreted the term "premium" to simply mean the amount due. Petitioner also notes that the sum represented as the total premium does include taxes and stamp fees which DOI has not regarded as part of premiums when they are separately itemized. Accordingly, petitioner asserts that the inclusion of the fees at issue as part of the "Premium Total" or "Total Policy Premium" does not clearly show that the fees are part of taxable gross premiums.

In support of their respective positions, petitioner and DOI refer to various bulletins distributed by DOI and to various court cases. While we have analyzed the bulletins and addressed the parties' interpretation of them, our conclusion in this matter is based on the legal authorities which are binding authority in this dispute. The tax imposed by Insurance Code section 1775.5 on the gross premiums charged by a surplus line broker is the "substitute" for the tax imposed by California Constitution, Article XIII, section 28, and by the Tax on Insurers Law, Revenue and Taxation Code, section 12001, et seq., on the gross premiums received by admitted insurers. The term "gross premiums" as used by Insurance Code section 1775.5 is intended to have the same meaning as the same term used by the Tax on Insurers Law. Thus, while there are no court cases that interpret "gross premiums" specifically for purposes of Insurance Code section 1775.5, there are court cases interpreting that term for purposes of the Tax on Insurers Law, and those cases are equally applicable here.

In *Groves v. City of Los Angeles* (1953) 40 Cal.2d 751 ("*Groves*"), the California Supreme Court considered a tax imposed by the City of Los Angeles on the gross receipts of sellers of bail bonds, with gross receipts being defined to exclude insurance premiums. In *Groves*, the court held that the full amount paid by the insured for the insurance, that is, the cost of the insurance to the insured, was part of the insurer's taxable gross premiums. Applying the same analysis, we conclude that the tax asserted against petitioner on amounts petitioner charged and retained for insurance placed

STATE BOARD OF EQUALIZATION
TAX ON INSURERS APPEAL

with nonadmitted insurers must also be upheld. We further find that such amounts include the fees at issue.

A logical and common sense view of the facts dictates the very same conclusion. Petitioner billed the inspection fees and policy fees to the retail insurance brokers as a condition for issuing the insurance policy on behalf of the insurer, and, if the customer wished to purchase that insurance, payment of those fees was mandatory. As such, regardless of how the fees may have been characterized to the insured, the insureds certainly understood that their cost of insurance included payment of such fees, whether separately itemized or just identified to the insureds as a lump sum charge. Thus, we find petitioner does not have a legitimate basis for arguing that the disputed fees were not part of the cost of insurance to the insureds. Consequently, we find the fees at issue represent taxable gross premiums.

OTHER MATTERS

None.

Summary prepared by Deborah A. Cumins, Business Taxes Specialist III

STATE BOARD OF EQUALIZATION
TAX ON INSURERS APPEAL