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WORLD CAPTIVE FORUM

State Regulation Again! Time for a Fresh Look

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Our Panel

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Current Landscape - How Did We Get Here?

- The regulatory environment
- McCarran-Ferguson Act and Todd Shipyards
- Dodd-Frank Wall Street Reform and Consumer Protection Act
- Microsoft Settlement
- Johnson & Johnson New Jersey tax case

The Regulatory Environment

- Self-insurance and captive programs continue to be a focus of governmental agencies looking for new tax revenues and regulations, and some states have taken to attracting new captives with hopes of increasing revenue.
- Enactment of Nonadmitted and Reinsurance Reform Act (NRRA) has brought new attention to issues surrounding state regulation and taxation of captive insurance

Todd Shipyards (S. Ct. 1962)

- McCarran-Ferguson Act places limitations on state authority to regulate and tax interstate insurance transactions
- But facts were narrow
  - No solicitation of business in state
  - No investigation of risks or claims in state
  - Policies negotiated and paid for outside Texas
  - Policies issued outside Texas
  - All losses adjusted and paid outside Texas
  - Insurers had no office or place of business in Texas
  - Insurers were not licensed in Texas
- Lower courts have construed Todd Shipyards narrowly

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Dodd-Frank

- Because of Dodd-Frank, more states have attempted to impose direct procurement taxes on captive transactions.
- Since the enactment of the Non-admitted and Reinsurance Reform Act (the "NRRA") as part of the Dodd-Frank Act, captive owners and advisors around the country have been engaged in discussion and debate over the impact of the NRRA on the state tax profile of captive insurance arrangements. Most believe that NRRA now applies to captive arrangements and captive owners would be well advised to review their existing structure and policies and consider whether certain state tax risks can be minimized or eliminated.
- Meanwhile, states have attempted to impose direct procurement taxes or have encouraged organization to redomesticate captives to their domicile.

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Nonadmitted and Reinsurance Reform Act

- "Nonadmitted insurance" mean "any property and casualty insurance permitted to be placed directly or through a surplus lines broker with a nonadmitted insurer eligible to accept such insurance."
- No state other than the "home state" of an insured may require any premium tax payment for nonadmitted insurance.
- Special rule for policy with multiple affiliated named insureds
- Special rule for cases where 100% of insured risk located outside state of insured's principal place of business

Microsoft

- In May of 2018, the Insurance Commissioner of Washington state issued a cease-and-desist to Microsoft.
- This order required that Cypress (Microsoft's AZ-based captive) stop selling insurance to its parent company and asked for about $1.4M in unpaid premium taxes.
- The Insurance Commissioner believed that Microsoft was in non-compliance as it did not pay 2% premium taxes for the business that Cypress had underwritten. It was further contended that as Cypress did not hold a certificate of authority to sell insurance in the State of Washington, and the coverage should have been placed through a surplus lines broker licensed in Washington.
- In response, Microsoft began using a surplus lines broker and settled the case with the commissioner in August by paying $867,820.

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Johnson & Johnson

- New Jersey-based organization with a captive, Middlesex Assurance Company, domiciled in Vermont
- In NJ, the Independent Procurement Tax (IPT) is imposed upon the premiums paid by a business for insurance that is procured from an unauthorized insurer other than through a surplus lines broker
- Initially, J&J paid IPT to NJ only for its risks covered in the state after NJ enacted law in response to the NRRA, began paying tax on all U.S. premium as a precautionary measure
- J&J sought refund of taxes paid for premiums covering non-NJ risks
- The State of New Jersey contended that under NJ law and NRRA, tax was owed on premiums written for all risks within the US, not just for those residing in the state and denied refund
- J&J argued that the language in NJ law enacted in response to NRRA only related to surplus lines of business - they ultimately lost the battle and did not receive the $55M of refunds they requested for
- Other states may follow suit because of the success out of New Jersey and Washington

Alternatives

- Take a broad view of *Todd Shipyards* and, as much as possible, keep captive's activities within its domicile
- Front the coverage with an admitted carrier
- Form a risk retention group
- Take advantage of direct procurement, industrial insured or other state exception to licensing
- Form a trust
- Place captive in home state

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