

July 20, 2022

Re: Comments in response to Draft ETA re the Insurance Exemption

Dear Director Smith and Members of the Department of Revenue Executive Team:

On behalf of the American Council of Life Insurers (ACLI),¹ the American Property Casualty Insurance Association (APCIA),² the National Association of Mutual Insurance Companies (NAMIC),³ the Northwest Insurance Council (NWIC),⁴ the Association of Washington Businesses (AWB),⁵ and the Council On State Taxation (COST),⁶ this letter is being submitted to express serious concerns regarding the Department's draft excise tax advisory (Draft ETA) on the insurance business exemption. The Draft ETA fails: (i) to comport with the plain language of RCW 82.04.320, (ii) to provide an effective date or otherwise address the retroactive application

¹ The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 94 percent of industry assets in the United States and 94% of the life insurance premiums in Washington.

² The American Property Casualty Insurance Association (APCIA) is the primary national trade association for home, auto, and business insurers. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members represent all sizes, structures, and regions—protecting families, communities, and businesses in the U.S. and across the globe.

³ The National Association of Mutual Insurance Companies (NAMIC) membership includes more than 1,500 member companies. The association supports regional and local mutual insurance companies on main streets across America and many of the country's largest national insurers. NAMIC member companies write \$323 billion in annual premiums. Our members account for 67 percent of homeowners, 55 percent of automobile, and 32 percent of the business insurance markets. Through our advocacy programs we promote public policy solutions that benefit NAMIC member companies and the policyholders they serve and foster greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies.

⁴ Northwest Insurance Council (NWIC) is a non-profit, insurer-supported organization that provides information about auto, home and business insurance to consumers, media and policymakers in Washington, Oregon and Idaho.

⁵ Formed in 1904, the Association of Washington Business is Washington's oldest and largest statewide business association and includes nearly 7,000 members representing 700,000 employees. AWB serves as both the state's chamber of commerce and the manufacturing and technology association. While its membership includes major employers like Boeing and Microsoft, 92% of AWB members employ fewer than 100 people. More than half of AWB's members employ fewer than 10. For more about AWB, visit www.awb.org.

⁶ The Council On State Taxation (COST) is a non-profit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of over 500 major corporations engaged in interstate and international business, many of which are incorporated and do business in Washington. COST's objective is to preserve and promote the equitable and non-discriminatory state and local taxation of multijurisdictional business entities.

of this rule or the Department's 2019 withdrawal of its longstanding precedent, and (iii) to consider the impact this change may have on Washingtonian policy holders.

RCW 82.04.320 and the Department's longstanding precedential determination that provided the functionally related test have been staples—upon which operational and budgetary planning have been based—for the insurance industry in Washington for three decades. The Draft ETA turns that on its head. Considering the significance of the Department's policy shift and the extreme impact this will have on the insurance industry as a whole, we respectfully request the Department schedule a series of interested parties meetings to critically examine this issue in its entirety.

The Draft ETA Fails to Comport with RCW 82.04.320

RCW 82.04.320 provides an exemption from the B&O tax to “any person [except insurance agents or brokers] in respect to insurance business upon which a tax based on gross premiums is paid to the state.”

The Draft ETA, reversing thirty years of Department precedent, explains that “[d]etermining whether a person's activities are in respect to the insurance business is a fact-specific inquiry.” It then enumerates a narrow list of activities that the Department considers to be “directly relating to the insurance business.”

The Draft ETA also delimits the class of persons who may claim the insurance business exemption to those “engaged in insurance business that receive gross income that is taxed under a gross premium tax paid to Washington.” It goes on to state that “[t]he person claiming the exemption must show proof of payment of Washington premium tax with respect to the gross income the person is claiming to be exempt from B&O tax.”

The Department's interpretation of RCW 82.04.320 in the Draft ETA is contrary to the plain language of the statute. The language in the exemption statute does *not* require that a person's activities be “directly” related to an insurance business to be exempt from the B&O tax. By adding the “directly related” requirement, the Department thus unduly narrows scope of the exemption.

The Department's second—and novel—additional requirement that the company claiming the exemption have proof of payment of Washington premiums tax “with respect to” the income claimed to be exempt is also contrary to the insurance business exemption's plain language and legislative history. The predecessor to the current insurance business exemption provided an exemption for “[i]nsurance companies *which pay* to the State of Washington a tax upon gross premiums.” That language was not included in the current iteration of the insurance business exemption, which has been largely undisturbed since 1935. By removing that limiting language, and adding “in respect to” as a qualifier for the exempt receipts, the legislature expressed its intent to broadly apply the insurance business exemption to entities other than those which pay gross premiums tax.

The taxation of insurance companies at the state level is generally covered under a premiums tax regime that is overseen by a specific state agency that governs insurance more generally. In Washington, this is the Office of the Insurance Commission (OIC). To prevent

duplicative taxation and to ensure the integrity of the regulated rate structures to which insurance companies are subject, states also generally include what is referred to as an “in lieu of” provision within state law. RCW 48.14.080 is Washington’s “in lieu of” provision, and it explicitly provides that insurance companies are subject to premiums taxes *in lieu of all other taxes*, with limited exceptions.

By requiring the person claiming the exemption to show proof of payment of premiums tax “with respect to the gross income the person is claiming to be exempt,” the Department effectively abrogates the B&O tax exemption (RCW 82.04.320), since such receipts are covered by the “in lieu of” provision in RCW 48.14.080. Thus, if a premiums tax was paid, those receipts would already be exempt from other taxes, including the B&O tax, pursuant to the “in lieu of” provision. The Department’s position as provided in the ETA narrows the scope of the B&O tax exemption to the point of eliminating its existence and rendering that provision meaningless.

Finally, even if one is to assume the Department’s position is sound and based on solid legal footing, the language in the Draft ETA concerning the class of persons entitled to claim the exemption is difficult to parse. The language discussed above makes it unclear if an entity must be a registered insurance company in order to claim the exemption, or if the receipts at issue must also be subject to a gross premiums tax. As discussed above, as currently written, the Department’s language regarding the class of persons entitled to claim the insurance business exemption, when read in conjunction with the “in lieu of” provision, is confusing. At a minimum, the Department should clarify what gross receipts are exempt under the “in lieu of” provision that are not already covered by the insurance business exemption and vice versa. And because the Draft ETA could impact the “in lieu of” provision, we encourage the Department to seek input and advice from the OIC before finalizing the Draft ETA.

The Draft ETA Fails to Provide an Effective Date

The Draft ETA fails to provide an effective date. Considering that this is a 180-degree shift in the Department’s position, it would be entirely reasonable for industry stakeholders to presume that the withdrawal of a thirty year old precedent that has been woven into the fabric of the insurance business in Washington would be applied prospectively only, yet the Draft ETA leaves open this critical point.

Moreover, if the Department intends to apply the Draft ETA to tax periods before October 2019, when the interim guidance was issued, it should seriously reconsider doing so. The Department’s published determinations are considered binding precedent.⁷ Taxpayers should be able to rely, and have in fact relied, on the now withdrawn determination for thirty years. Without the assurance that the Department will not apply the Draft ETA (or the interim guidance) until after this ETA is finalized, the Department establishes a dangerous precedent—taxpayers would never be able to close their books, and this could significantly impact tax contingency reporting

⁷ See RCW § 82.32.410

on publicly filed financial statements since the Department's position could change at the its discretion with retroactive effect.⁸

Thus, the Department should clarify: (1) to what tax periods the interim guidance will apply, (2) to what tax periods the Draft ETA will apply, and (3) to what tax periods the final ETA will apply. Significantly, the Department should bear in mind that taxpayers have rightfully relied on the Department's previous interpretation for three decades in structuring their business. We encourage the Department to assure taxpayers that the "functionally related" test will be applied for tax periods prior and up to October 2019, and to explain how the Draft ETA differs, if at all, from the interim guidance.

The Policy Embodied in the Draft ETA May Result in Higher Premiums for Washingtonians

The B&O tax on receipts from activities that no longer qualify for the insurance business exemption will likely be passed on to Washingtonians in future premiums. As a result, the additional taxes that will result from the Department's policy likely reduce the affordability of these products that protect families' financial futures. Public policies should make it easier, not harder, for Washingtonians to secure financial protection. But the Draft ETA does the opposite, and could have a profound impact on the products offered by life and property and casualty insurers.

For example, life insurance contracts are extremely long-term, sometimes longer than 100 years. The retraction of the prior guidance, the Draft ETA (which is completely at odds with prior guidance), and the threat of retroactivity makes it very problematic for life insurers to accurately price contracts that will last decades.

Property and casualty insurers similarly face pricing issues, and unlike life insurers, must receive approval from the OIC for their rates. In submitting rate approval requests, members have relied on the Department's historical precedents to estimate costs which premiums offset. The Department's unanticipated change applied retroactively thrusts upon some members an unexpected and unfair expense which was not accounted for in prior rate requests.

Moreover, the abrupt manner in which the Department is reversing its policy throws into doubt all guidance the department has or will issue. As noted, life insurers in particular will have an increasingly difficult exercise when pricing policies. We urge the Department to coordinate its renewed interpretation of the insurance business exemption with the OIC or at the very least to consider the impact this policy shift will have on Washingtonians.

Request for Additional Public Engagement—Interested Parties Meetings

Considering the significant implications the Department's policy shift and this Draft ETA will have on the entire insurance industry, it would be appropriate for the Department to form a working group and schedule a series of interested parties meetings to engage with industry stakeholders on this issue. If the Department is unwilling to engage with industry stakeholders in

⁸ See *Stroh Brewery v. Department of Revenue*, 104 Wn. App. 235 (Wash. Ct. App. 2001).

a public setting on this issue, we would ask the Department to respond to these comments in writing to explain how the Department has addressed, or the Department's reason for not addressing, each of the concerns raised above.

Your attention to these concerns are appreciated, and we look forward to working with you further on this issue.



Sincerely yours,

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