



Janet Napolitano
Governor

Gale Garrriott
Director

PRIVATE TAXPAYER RULING LR08-010

October 27, 2008

The Department issues this private taxpayer ruling in response to your letter of August 25, 2008, requesting a ruling on behalf of ("Taxpayer"). Specifically, you request the Department rule on the applicability of Arizona's corporate income tax on Taxpayer, an insurance company that files a zero liability gross premium tax return in Arizona.

Statement of Facts:

Taxpayer is an insurance company and wholly owned indirect subsidiary of "...". Taxpayer was formed in 2005 exclusively to provide benefits as a prescription drug plan under the federal Government's Medicare Part D program administered by the Centers for Medicare and Medicaid Services ("CMS"). Taxpayer commenced operations on January 1, 2006.

From its inception, Taxpayer has solely offered Medicare to eligible participants in all fifty states, the District of Columbia and the territories of Puerto Rico and the U.S. Virgin Islands. As of December 31, 2007, Taxpayer was licensed as an insurer in thirty-six states and the District of Columbia and has filed expansion applications to become a licensed insurer in the states where it is required to do so, and will file applications in the remaining states upon satisfaction of seasoning requirements. Taxpayer operates under a waiver from CMS in the states where it is not licensed. In addition to filing license applications, Taxpayer files zero liability gross premiums tax returns in all applicable states, including Arizona.

Questions Presented by Taxpayer:

1. Is Taxpayer subject to Arizona's insurance premium tax, even though its Medicare Part D premiums are exempt pursuant to federal law?
2. If Taxpayer is subject to Arizona's insurance premium tax, then is Taxpayer exempt from Arizona corporate income tax?

Relevant Statutory Law:

Medicare Part D premiums are federally subsidized premiums received for prescription drug benefits provided to Medicare beneficiaries in the United States. States are prohibited, by federal statute, from imposing a premiums tax or fee on such receipts. Specifically, federal law does not allow states to impose a premiums tax, fee or other

PRIVATE TAXPAYER RULING LR08-010

October 27, 2008

Page 2

similar assessment on any payment CMS makes on behalf of a Medicare Part D plan or enrollees or on any payment made to Medicare Part D plans by a beneficiary or by a third party on behalf of a beneficiary. 42 C.F.R. § 423.440(b) (2005).

Arizona Revised Statute (A.R.S.) § 43-1111 provides there shall be:

levied, collected and paid for each taxable year upon the entire Arizona taxable income of every corporation, unless exempt under section 43-1126 or 43-1201 or as otherwise provided in this title or by law, taxes in an amount of 6.968 per cent of net income or fifty dollars, whichever is greater.

Organizations exempt from Arizona corporate income tax under A.R.S. § 43-1201(14) include insurance companies paying to the state upon premium income derived from sources within this state.

A.R.S. § 20-224(A) instructs “each authorized domestic insurer, each other insurer and each formerly authorized insurer...[to] file with the director a report in the form prescribed by the director showing total direct premium income.”

A.R.S. § 20-224(B) imposes upon each insurer a tax of 2.0 percent of such net premiums.

A.R.S. § 20-226 provides:

- A. With respect to authorized insurers the premium tax provided by section 20-224 shall be payment in full and in lieu of all other demands for any and all state, county, district, municipal and school taxes, licenses and excises of whatever kind or character, excepting only:
 - 1. The fees prescribed by this title.
 - 2. Taxes on real and tangible personal property located within this state.
 - 3. The transaction privilege tax and the use tax imposed as provided in title 42, chapter 5, articles 1 and 4.
 - 4. The transaction privilege taxes and use taxes imposed by any county, city or town.
- B. Except as provided in subsection A of this section, the state preempts the field of imposing excise, privilege, franchise, income, license and similar taxes upon insurers and their general agents and agents as such and on the intangible property of insurers or such agents. Except as provided in subsection A of this section, no county, municipality, district, school district or other political subdivision or agency in this state shall levy upon insurers, or upon their general agents and agents as such, any tax additional to such as are levied in this title. Nothing in this section allows a county, city or town to impose a transaction privilege tax or use tax on insurance policies, premiums, brokers or agents.

PRIVATE TAXPAYER RULING LR08-010

October 27, 2008

Page 3

Relevant Arizona Case Law:

All exemptions from taxation should be strictly construed. See generally *City of Phoenix v. Bowles*, 65 Ariz. 315, 180 P.2d 222 (1947).

There is a wide difference between a "lieu tax" and an exemption from taxation. The "lieu tax" is a substituted tax. *State Tax Commission v. Shattuck*, 44 Ariz. 379, 391, 38 P.2d 631, 636 (1934).

In *Prudential Insurance*, the Arizona Supreme held the Arizona legislature intended to limit the taxation of insurance companies to the taxes set forth in A.R.S. §§ 20-224 and 20-226. *City of Tempe v. Prudential Insurance Co. of America*, 109 Ariz. 429, 510 P.2d 745 (1973).

Taxpayer Position:

Although, pursuant to federal law, 100% of its premiums are exempt from Arizona's insurance premium tax, Taxpayer constitutes an insurance company subject to the Arizona statutes governing the taxation of insurance companies, and is therefore subject to the Arizona insurance premium tax. Per Arizona statute, as an insurance company subject to Arizona's insurance premium tax, Taxpayer should be exempt from Arizona corporate income tax.

Conclusion and Ruling:

As a domestic insurer doing business in Arizona, Taxpayer is subject to Arizona's insurance premium tax. As stated in the facts above, Taxpayer was formed and currently operates only to provide benefits under the federal Government's Medicare Part D program. As a result of federal law prohibiting state and local taxation of Medicare Part D premiums, Taxpayer does not actually pay any Arizona insurance premium tax. While the federal prohibition of state and local taxes being levied on Medicare Part D premiums may result in Taxpayer having zero insurance premium tax liability, Taxpayer is still technically subject to Arizona's insurance premium tax.

While tax exemptions are generally strictly construed against the taxpayer, the Arizona insurance premium tax is a substitute tax and not an exemption from taxation. This distinction along with the clear language of A.R.S. § 20-226 led the court in *Prudential Insurance* to conclude the Arizona legislature intended to limit the taxation of insurance companies to the taxes set forth in A.R.S. §§ 20-224 and 20-226. Therefore insurance companies are only subject to Arizona's insurance premium tax and those taxes specifically listed in A.R.S. § 20-226(A)(1-4). The taxes enumerated in A.R.S. § 20-226(A)(1-4) are limited to insurance fees, property taxes, and state, county and city transaction privilege taxes. As a result, Taxpayer is not subject to Arizona's corporate income tax.

PRIVATE TAXPAYER RULING LR08-010

October 27, 2008

Page 4

This private taxpayer ruling does not extend beyond the facts presented in your letter and enclosed documents of August 25, 2008.

This response is a private taxpayer ruling and the determinations herein are based solely on the facts provided in your request. The determinations are subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the Department's making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to the future change depending on changes in the statutes, administrative rules, case law or notification of a different Department position.

The determinations in this private taxpayer ruling are applicable only to the taxpayer requesting the ruling and may not be relied upon, cited nor introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the private taxpayer ruling.

Lrulings/08-010-D