



Janice K. Brewer
Governor

PRIVATE TAXPAYER RULING LR10-010

July 8, 2010

Gale Garriott
Director

The Department issues this private taxpayer ruling in response to your letter of May 10, 2010, 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 zero liability gross premium tax returns in Arizona.

Statement of Facts

Taxpayer, an Arizona Corporation, . . . is a wholly-owned subsidiary of . . . , a California corporation. . . . is owned by . . . , and its ultimate parent is . . .

Taxpayer was incorporated in Arizona on December 1, 2008 and commenced operations in January 2010. Taxpayer is licensed by the State of Arizona, Department of Insurance as a Health Care Services Plan and its certificate of authority is limited to Medicare Advantage health plans.

Taxpayer provides health care services to enrollees in the Medicare advantage program in Arizona through its contract with the Centers for Medicare and Medicaid Services (“CMS”). Under the terms of its contract with CMS Taxpayer receives payments from CMS for the provision of covered medical services to enrolled members. Taxpayer also serves as a plan sponsor offering Medicare Advantage and Medicare Part D prescription drug insurance coverage under the contract with CMS. Taxpayer files insurance premium tax returns with the Arizona Department of Insurance.

Issues

1. Is Taxpayer subject to Arizona’s insurance premium tax, even though its premiums are exempt under 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:

No premium tax, fee, or other similar assessment may be imposed by any State, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, and America Samoa, or any of their political subdivisions or other governmental authorities with respect to any payment CMS makes on behalf of Medicare Advantage enrollees under subpart G of this part, or with respect to any payment made to Medicare Advantage plans

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by beneficiaries, or payment to Medicare Advantage plans by a third part on a beneficiary's behalf. 42 C.F.R. § 422.404.

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.

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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:

Taxpayer is licensed as a Health Services Plan by the Arizona Department of Insurance and is subject to the Arizona's insurance premium tax. Taxpayer is prohibited by federal law from paying premium taxes on payments it receives from CMS. Arizona law provides that corporations subject to its insurance premium tax are not subject to its corporate income tax. Since Taxpayer is subject to Arizona's insurance premium tax, it is not subject to Arizona's 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 above, Taxpayer is prohibited by federal law from paying premium taxes on payments it receives from CMS. As a result of federal law prohibiting state and local taxation of its premiums, Taxpayer does not actually pay any Arizona insurance premium tax. While the federal prohibition of state and local taxes being levied on 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.

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This response is a private taxpayer ruling and the determination herein is 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 future change depending on changes in statutes, administrative rules, case law, or notification of a different Department position.

The determinations in this private taxpayer ruling are only applicable to the taxpayer requesting the ruling and may not be relied upon, cited, or introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the private taxpayer ruling.

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