



SURPLUS LINES BULLETIN NO. 15

TO: ALL SURPLUS LINES LICENSEES, DELAWARE INSUREDS WHO INDEPENDENTLY PROCURE NONADMITTED INSURANCE, AND INTERESTED PARTIES

RE: Clarification of New Surplus Lines Premium Tax Rate Implementation

DATED: September 10, 2014

PURPOSE

The purpose of this bulletin is to answer several questions that have arisen since House Bill 213 with House Amendment 1, which changed the amount of tax payable on surplus lines policies, from a 2% tax to a 3% tax (18 Del. C. §1925 (b)), was signed into law on July 30, 2014.

BACKGROUND

On August 11, 2014, the Delaware Department of Insurance issued Surplus Lines Bulletin No. 14 for the purpose of informing individual surplus lines licensees, surplus lines compliance reporting staff, Delaware insureds who independently procure nonadmitted insurance, and other interested parties that Delaware's tax rate on premium for policies written with nonadmitted insurers covering risks for which Delaware is the home state of the insured was increased from 2% to 3% effective July 30, 2014.

Since the issuance of Surplus Lines Bulletin No.14, the Department has received a significant number of inquiries as to the implementation and application of this tax rate increase. Most questions are regarding the impact of HB 213, specifically with respect to how the legislation affects policies bound or quoted pre-enactment but that have an effective date after July 30, or policies already in effect that have premium-increasing endorsements issued post-enactment. This Bulletin will address these and other most commonly received questions.

QUESTIONS AND ANSWERS

1. Can the implementation of this tax rate increase be delayed to allow surplus lines brokers and retail/wholesale agents time to amend their policy transaction, tax collection and reporting processes?

No. Because this is a legislative change passed during the 147th General Assembly and signed into law by Delaware Governor Jack Markell on July 30, 2014, the tax rate change is effective as of

the date of signing. The Insurance Commissioner does not have the authority to delay implementation of this legislative change to the law.

However, Delaware Insurance Commissioner Karen Weldin Stewart is mindful of the potential administrative difficulties facing surplus lines brokers, retail/wholesale agents and policyholders due to the immediacy of this implementation.

In an effort to ease some of this burden, Commissioner Stewart has declared a moratorium on late filing penalties for policy reports due within 30 days of the effective date. This moratorium shall apply to all surplus lines business effective during the months of July and August 2014, to allow surplus lines brokers and retail/wholesale agents time to make revisions and collect the increased tax amounts.

This moratorium shall be extended to include the third and fourth quarter premium tax reports as limited by the following instructions:

- On each quarterly tax report, surplus lines brokers should report only that business for which they have been able to collect the full and proper amount of premium tax according to the implementation of this tax rate change.
- Business still in the “collection” phase should not be reported until the transaction is fully completed. *For example*, if a policy was written in August but only 2% tax was charged thereby requiring that the additional 1% still be collected, and if the additional tax is not collected before the October 30th due date for the third quarter report, that policy should be included in the fourth quarter report.

Please note that although this moratorium is applicable to filings during the rest of calendar year 2014, the Delaware Department of Insurance fully expects that all difficulties associated with implementation of this law, including report preparation and premium tax collection, will be resolved by calendar year-end.

All surplus lines broker and property-casualty producer licensees involved in surplus lines policy transactions are advised to use any available means to contact policyholders to inform them of the tax rate change and to collect the full amount of premium tax. Commissioner Stewart has given until March 1, 2015, for tax collections to be completed and submitted.

The Department considers this ample time for the collection of any additional tax due to this law change, and requires that the 2014 annual surplus lines premium tax summary report, due on or before March 1, 2015, be complete and accurate and submitted in a timely manner. **Any premium tax not reported previously due to implementation delays should be reported on the annual report and payment included with that filing. *The moratorium on late filing penalties shall not extend to include the 2014 annual premium tax summary report.***

2. Does this law as described in Surplus Lines Bulletin No. 14 only affect independent procurement? Does this change apply to Risk Purchasing Groups?

This tax rate increase applies to ALL surplus lines policies, including independently procured policies and policies procured on behalf of Risk Purchasing Groups. The tax rate change applies

to all premiums, including premium charged for new business, renewal business, subscription type policies, and additional premium charged for endorsements.

3. The 3% tax is on premiums plus fees correct?

Fees are considered part of the premium by definition, so they should be taxed (18 Del. C. §1904(a)(8)).

4. What do we do about the policies already bound and quoted with an effective date after 07/30/2014 with the 2% tax rate?

Tax should be applied at the rate in effect when the insured is charged the premium for the policy. Premiums charged after July 30, 2014 for surplus lines policies shall be taxed at the rate of 3%. Premiums charged on or before July 30, 2014 for surplus lines policies shall be taxed at the former rate of 2%.

Additional clarification regarding “**Bound**” business and “**Quoted**” business:

When a policy is **bound**, there is basically a temporary contract (binder) made with the insurance company to provide insurance coverage until such time as a finalized policy product can be issued by the company. Premium tax on bound policies should be calculated at the rate in effect when the premium is charged to the client for the binder. If the policy is issued with no changes to the premium charged at the time the binder was issued, and the policy simply replaces the binder, the premium tax rate remains the same based on the date of the binder, since no additional premium is charged. If, however, the insurer issues a revised binder or there are changes to the policy when it is issued, which affect the premium charged for the policy, then the premium tax must instead be calculated at the rate in effect on the date the client is charged for the revised binder or the actual premium amount on the finalized policy.

If business was **quoted** before July 30, 2014, and the amount presented to the client was calculated to include 2% tax, however, no premium was charged to the client at that time, and if the actual premium gets charged to the insured after July 30th, the previously quoted tax amount must be changed to reflect the 3% tax rate. The same is true for renewal offers. If renewal offers have been presented at a 2% tax rate, but the actual premium was or will be charged to the client after July 30, 2014, the quoted premium must be taxed at 3%.

The Department strongly suggests surplus lines brokers and retail/wholesale agents work together to contact their clients and explain the tax increase to them; letting them know that the tax amount they are responsible for paying will be calculated at 3% instead of the original quoted rate of 2%.

5. Who is responsible for covering the 1% premium tax gap?

The insured is responsible for covering the 1% premium tax gap. **In order to comply with anti-rebating statutes, agents and brokers may not cover the 1% premium tax gap.** Clients should be notified that the tax rate has changed, and that the amount of premium they will be charged will increase to include the additional tax. It is the insured’s prerogative whether to continue with the full policy transaction, and pay the additional tax or choose cancellation.

IMPORTANT: Commissioner Stewart has given until March 1, 2015, for tax collections to be completed and submitted. Therefore, it is in the best interest of the policyholders that unless the policyholder so chooses, policies on which additional premium tax is due shall not be cancelled for reason of failure to pay premium tax prior to February 13, 2015. If a policy is cancelled after that date for failure to pay premium tax, documentation must be submitted showing the surplus lines broker and property-casualty producer (if applicable) involved in surplus lines policy transaction made a concerted effort to collect the additional premium tax from the policyholder prior to the cancellation.

6. Does that mean we need to go back to any and all surplus lines business written as of July 31st that was billed at the 2% rate and reprocess them? Would that reprocess just include collecting 1% more tax?

Yes. Business written on or after July 31st and taxed at the 2% rate must be reprocessed. The law was signed into effect on July 30th, making the 30th the effective date of the new tax rate. So, all business written after July 30, 2014 must be taxed at 3%.

Again, the Department strongly suggests that surplus lines brokers and/or retail/wholesale agents contact their clients and explain the tax increase to them. It is imperative that insureds be told that the tax amount they are responsible for paying is being recalculated at the increased 3% tax rate, and that they must pay the difference in the tax amount. It is the licensee's responsibility to collect the correct amount of premium tax from the insured and submit it to the State of Delaware.

The Department is updating the quarterly tax forms, which will have distinct sections to report premiums separately based on tax rate. In each section there will be lines for premium written, returned premium and net premium. The tax on net premium in each section will be calculated at the appropriate tax rate. The net premium tax from each section will be summed to get the amount due.

If any business after July 30th was already reported using the 2% tax rate but should have been reported using the 3% tax rate, an amended report must be filed with the Department to account for the difference. An amended SL-1905 Notice of Transaction form must be filed for each affected policy.

The updated SL-1905 Notice of Transaction electronic Excel® form is being changed to automatically calculate tax at the appropriate rate based on the date entered in the field labeled "Inception Date."

7. How does this tax change apply to endorsements? Is the rate based on the original effective date of the policy or the effective date of the endorsement?

Endorsements should be taxed at the rate in effect when the premium is charged for the endorsement, not necessarily the original policy date.

8. If a policy is issued prior to July 31, with a 2% tax rate and then endorsements with additional premium are added after July 31 at the 3% tax rate, and the policy is

eventually cancelled and premium must be returned, do you have guidance on how brokers should handle that situation?

The premium charged prior to July 31st for the original policy would be correctly taxed at the former 2% rate. The premium charged on or after July 31st for an endorsement would be correctly taxed at the 3% rate (after the law change effective July 30th).

If the policy is cancelled and premium must be returned, the tax on returned premium from the original coverage would be returned at 2% and the tax on returned premium from the endorsement coverage would be returned at 3%.

Tax from returned premium should be returned at the same rate in effect when the premium was charged; in this case 2% on the original policy and 3% on the endorsement.

CONCLUSION

As stated above, it is expected that by the time the calendar year 2014 annual premium tax report and payment is due in March 2015, the correct amount of premium tax, including any additional 1% tax for policies written after July 30th will have been collected and surplus lines brokers should be able to report and pay premium tax correctly.

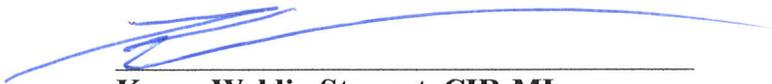
Although Commissioner Stewart has issued a moratorium on late filing penalties, surplus lines brokers should rigorously attempt to collect any additional 1% tax so they will be able to report and pay premium tax quarterly and in a timely manner.

Many brokers have expressed concern because they learned of this legislative change and the issuance of Surplus Lines Bulletin No. 14 through a third-party source.

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Karen Weldin Stewart, CIR-ML
Insurance Commissioner