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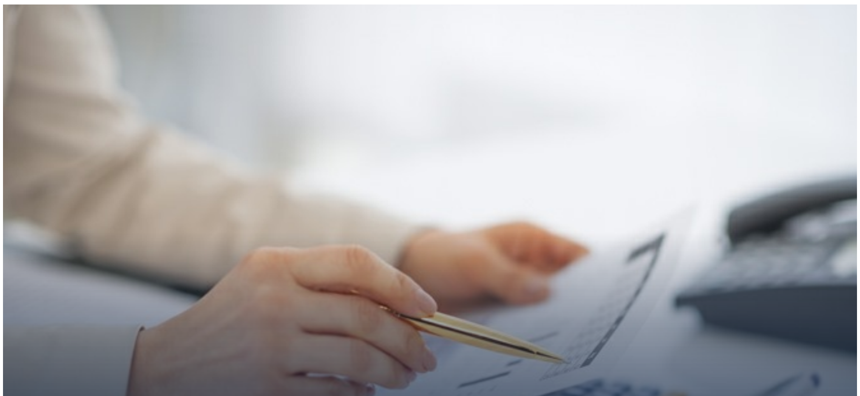

Industrial insureds in Illinois may be required to pay taxes on insurance premiums

TAX AND BENEFITS CHALLENGES | JUL 14, 2014

The Illinois General Assembly passed S.B. 3324 which imposes a 3.5 percent tax on paid premiums to unauthorized insurers by a certain class of businesses. The bill awaits Governor Patrick Quinn's signature. If the bill is neither signed nor vetoed by August 14, it automatically becomes law.

In some circumstances, states will tax insured businesses on the premiums they pay to insurers if such insurers are not authorized by the taxing state. In general, in Illinois, insurers are unauthorized if they do not maintain certificates of authority with the Illinois Director of Insurance. As a result, businesses operating in Illinois, therefore, typically cannot purchase insurance from an insurer that does not possess such a certificate.

An exception to this general rule is the "industrial insured" exception. Pursuant to 215 ILCS 121-2.08, a business is not obligated to purchase insurance from an authorized insurer if the business is an "industrial insured." An "industrial insured" is generally a business that meets certain threshold requirements, such as a certain employment-force size or minimum annual gross revenues. Along with the new tax on certain insurance premiums, S.B. 3324 will alter the definition of an industrial insured to substantially raise the threshold requirements that a business would need to meet in order to qualify as an industrial insured.

Under the Nonadmitted and Reinsurance Reform Act of 2010, which was enacted as part of the Dodd-Frank Act, only a business entity's home state may tax businesses on the premiums they pay to unauthorized insurers. 15 USC § 8202(a). Therefore, under current Illinois and federal law, a business whose home state (generally, where a business' principal place of business is located) is Illinois is not subject to state taxes on insurance premiums for unauthorized insurance in any state because Illinois does not currently impose such a tax and other states are prohibited by federal law from imposing such a tax on a business with an Illinois home-state.

The Illinois General Assembly passed S.B. 3324, amending 215 ILCS 121-2.08 and its applicability to industrial insureds. S.B. 3324 imposes the same tax on the premiums of unauthorized insurance policies that is imposed on surplus line transactions, which is 3.5 percent of the insurance premiums. The imposition of this tax on Illinois industrial insureds obtaining unauthorized insurance coverage would act to eliminate the tax savings advantage that Illinois businesses qualifying as industrial insureds have had by maintaining their Illinois home-state status.

S.B. 3324 would also require an annual filing with the Surplus Line Association of Illinois of substantially similar disclosures as those required of surplus line producers, such as:

1. The name of the unauthorized insurer;
2. A description and location of the insured property; and
3. The amount insured.

If it becomes law, S.B. 3324 would apply to insurance obtained on and after Jan. 1, 2015.