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Insurance: Self-procurement tax imposed on all U.S. premiums paid to captive (New Jersey Tax Court)

The New Jersey Tax Court concluded that a New Jersey corporation was liable for a self-procurement tax on 100% of the U.S. premiums paid to its captive insurance subsidiary. The court rejected the company's argument that it would pay the tax based only on the portion of premiums allocated to risks located in New Jersey.

The case is: *Johnson & Johnson v. Director, Division of Taxation,* No. 013502-2016 (N.J. Tax Ct. June 15, 2018). Read the New Jersey Tax Court's **opinion** [PDF 133 KB]

Background

The taxpayer is a New Jersey corporation engaged in a world-wide pharmaceutical, medical device, and consumer health care business. In 1994, the taxpayer formed a wholly owned, Vermont insurance subsidiary captive ("Middlesex Assurance"). Although Middlesex Assurance only does business in Vermont, it provides insurance coverage for the taxpayer's risks in other jurisdictions.

All transactions involving the purchase of the taxpayer's insurance coverage occur directly between Middlesex Assurance and the taxpayer's corporate risk management group, which is located in New Jersey.

New Jersey imposes an insurance premium tax on the premiums paid by an insured (the taxpayer, in this case) to its nonadmitted captive insurance company (Middlesex Assurance) under N.J.S.A. 17:22-6.64 ("self-procurement statute"). The taxpayer purchases all of its insurance coverage through its corporate risk management office in New Jersey. Due to a lack of sufficient minimum contacts with states other than New Jersey, the taxpayer pays self-procurement tax only to New Jersey (although Middlesex Assurance does pay a premium tax to Vermont).

The taxpayer began remitting self-procurement tax to New Jersey in 2008. The amount of tax due was calculated in conformance with the self-procurement statute, and was based on that portion of the premium allocated to risks in New Jersey.

“Home State Rule”

In 2010, the U.S. Congress enacted the *Nonadmitted and Reinsurance Reform Act of 2010* (“NRRA”). The NRRA created the “Home State Rule” under which no state other than the home state of an insured may impose a premium tax on nonadmitted insurance. This rule neither imposes a premium tax nor specifically states that the home state has the authority to tax 100% of U.S. premiums. Rather, the Home State Rule grants a home state the authority to tax all nonadmitted premiums in the United States.

In November 2011, the New Jersey legislature amended the relevant New Jersey tax statutes in response to the NRRA.

Refund claim

In light of the NRRA and New Jersey’s implementing legislation, the taxpayer paid the tax based on its total U.S. premiums, and then filed a refund claim.

- The taxpayer contended that the NRRA was intended to apply only to surplus lines insurance and reinsurance and did not apply to self-procured insurance.
- The taxpayer also claimed that New Jersey’s 2011 legislative changes in response to the NRRA likewise did not alter the calculation of self-procurement tax.
- The taxpayer challenged the position that the 2011 legislative changes altered the calculation of self-procurement tax on the grounds that the amendment refers only to surplus lines insurance and retains the original statutory language allocating self-procurement tax to risks located in New Jersey.

To support its argument that the NRRA does not apply to captive insurance companies, the taxpayer referred to statements by several congressional leaders that implied or specifically stated that the NRRA was not intended to apply to captive insurers.

The taxpayer further argued that, in general, Congress delegated the regulation of insurance companies to the states. To the extent that the Home State Rule provision of the NRRA overrides this general rule, the taxpayer asserted that, in light of the general history of delegation to the states, the Home State Rule is to be interpreted narrowly and does not apply to captive insurance companies unless Congress expresses a specific intent.

In response, the Director of the New Jersey Division of Taxation denied the taxpayer’s refund claim. The Director argued that the NRRA’s definition of “nonadmitted insurance,” includes both self-procured and surplus lines insurance, and that the New Jersey legislature intended to alter the calculation of self-procurement tax because the legislative history expresses the legislature’s intent to bring New Jersey law into compliance with the NRRA. The taxpayer thus filed a complaint with the New Jersey Tax Court.

New Jersey Tax Court's decision

The New Jersey Tax Court found in the Director's favor in a summary judgement opinion. The court focused on two issues.

- First, did Congress intend to apply the NRRA to captive insurance companies?
- Second, did the New Jersey legislature intend to incorporate the authority under the NRRA to both the surplus lines law and the self-procurement statute?

The New Jersey Tax Court noted that the NRRA sought to clarify and simplify the process for collecting nonadmitted premium taxes by creating a uniform system of premium taxation for nonadmitted insurance covering multistate risk. The court specifically noted 15 U.S.C. section 8201(a) provides that "…no state other than the home state of the insured may require any premium tax payment for nonadmitted insurance."

The court explained that the Home State Rule does not specify that a home state has the authority to tax 100% of U.S. premiums, but specifies that the home state has the authority to tax all nonadmitted insurance premiums in the United States. The statutory definition of "nonadmitted insurance" is "…any property and casualty insurance permitted to be placed directly or through a surplus lines broker with a nonadmitted insurer eligible to accept such insurance." 15 U.S.C. section 8206(9)

The court found that the definition of "nonadmitted insurance" includes both surplus lines insurance, which is sold through a surplus lines broker, and insurance that is placed directly with a nonadmitted insurer, such as a captive. The New Jersey Tax Court found the statutory language and the lack of any subsequent clarifying amendment were persuasive and held that the taxpayer's captive would be subject to the Home State Rule.

In addition, the state court held that the Home State Rule and the New Jersey conforming legislation did not violate the Due Process Clause under the 14th Amendment of the U.S. Constitution. The court noted that the Home State Rule, which ties the taxation of these insurance companies to the home state of the insured, was a legitimate exercise of the state's police power.

The New Jersey Tax Court continued to explain that the legislature intended to enact the NRRA-conforming amendments to cover the insurance premium tax provisions for all types of nonadmitted insurance, consistent with prior legislative changes to this statute. In sum, the court found "the legislative intent to be more persuasive than the precise language of N.J.S.A. 17:22-6.64."

KPMG observation

The opinion in this case is noteworthy for several reasons.

- First, the opinion is one of the first cases that analyzes the scope of the NRRA. The New Jersey Tax Court adopted a broad reading of the NRRA's Home State Rule.

- Second, the opinion extensively details the long and evolving history of the relationship between the federal and state governments with respect to the taxation of insurance companies. The court provided an informative history of the constitutional limitations associated with the taxation of procurement and surplus lines tax and how they apply.

Tax professionals believe that this detailed opinion is likely to be cited for its historical discussions—even if subsequent courts disagree with the holdings in this case.

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