

BRIEFINGS



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Proposed Title Insurance Premium Taxation Legislation Would Address Inequity of Taxing Insurers on Premiums They Don't Receive

Over the last couple of years, the Florida Legislature has considered legislation concerning the taxation of title insurance premiums. The sponsors offered the bills to address a perceived inequity in the way these premiums are taxed. Currently, title insurers are taxed on 100% of the premium paid by the customer, while they only actually receive 30% of the premium. The independent title insurance agent retains the rest. While the insurer is never in possession of this portion, they are liable for the insurance premium tax on it.

Legislation on this issue has again been filed for the 2007 Session. Florida TaxWatch has reviewed the proposed legislation and issues surrounding taxation of title insurance premiums and due to the unique nature of these premiums, concludes that current law does create an inequity. The law says that insurers are to be taxed on the "gross amount of such receipts." In practice, insurers are taxed on 100% of the premium, even though they are never in receipt of 70% of the premium.

Insurance Premium Taxation in Florida

Florida levies a tax on insurance premiums that is paid by insurance companies. The basic rate is 1.75% on gross premiums with other rates for annuities (1%), self-insurers (1.6%) and surplus lines (5%). Insurers are allowed certain credits against this tax liability, including credits for corporate income paid and part of the salaries paid to Florida-based employees (these two credits cannot exceed 65% of total liability). The insurance premium tax produces \$741 million for the state, most of which goes to general revenue.

The current law states that the tax on title insurance premiums (and most other insurance premiums) is 1.75% on the "gross amount of such receipts."

This has been interpreted as the total amount paid for the policy, including the portion retained by the agent. Again, the insurer is never in receipt of that part of the premium.

The definition of title insurance “premium”, contained in subsection 627.7711(2), does include the charge for performance of primary title services by a title insurer or title insurance agent or agency, but goes on to say that the word “premium” does not include a commission.

Title Insurance and Title Insurance Premiums Differ from Other Insurance

A title insurance policy protects the purchaser of that property from defects that may exist in prior transfers of title for the property being purchased. In real estate transactions, the assurance of good title is critical. Title insurance is a relatively small, but very important, part of Florida’s insurance industry. Title insurance premiums comprise 5.4% of total property and casualty premiums in the state. Fueled by Florida’s housing boom and escalating real estate values, premiums have also been growing rapidly, increasing 310% from 1995-2004 (most recent readily available data). Total Florida title insurance premiums of \$1.8 billion in 2004 is more than double what it was just three years prior.

Title insurance differs from other insurance in several fundamental ways. In typical property and casualty insurance, the insurer accepts responsibility for future risks that are out of its control. Title insurance insures against past events that may threaten the ownership interest in the property. In addition, there is no fixed term of coverage-the insurers maintains liability in perpetuity. Also, the policy cannot be cancelled by either the company or the insured.

The most important and pertinent distinction in respect to this premium tax issue is that a title insurance premium is a one-time charge that is primarily a service fee to cover the expense of searching the public record and only a small portion of the premium is paid out in claims.

In Florida, it is common practice in the title insurance industry for policies to be written by independent agents that are then underwritten by title insurance companies. These agents perform most of the same duties as other agents such as marketing and producing policies. However, title insurance agents perform many other duties as well, including title searches and examinations, reviewing public documents, handling funds in escrow, preparing closing documents and conducting closings.

Since the insurer’s exposure comes from past occurrences, the focus is on risk mitigation. Agents do the up-front work to identify risks, and known risks are eliminated from coverage. Since the insurer does not assume known risks, the number of claims is relatively small.

So while most of a traditional insurance premium goes to cover risk, most of the premium for title insurance goes to the agent to perform the up-front services. To pay for these services, the customer pays the agent, not the insurer, the entire premium. In Florida, the agent typically retains 70% of the premium for the services rendered and then transfers 30% to the underwriter to cover risk. Florida law provided that insurers may not received less than 30% of the premium. This is the only part of the premium that the insurer is ever actually in possession of, the 70% stays with the agent.

This is different than other types of property and casualty insurance where the insurer receives 100% of the premium and keeps about 90%.

2007 Legislation

Two bills have been filed for the 2007 Session to address this situation: House Bill 617, sponsored by Representative Mark Mahon, and Senate Bill 2486, sponsored by Senator Mike Haridopolos, Chair of the Senate Committee on Finance and Tax. These two bills are identical, making a simple and straightforward amendment to subsection 624.504(1), *Florida Statutes*, along with two conforming amendments.

The proposed legislation states that the premium tax on title insurance would be:

An amount equal to 1.75 percent of the gross receipts on title insurance written through affiliated and nonaffiliated agencies, less the portion of the gross receipts retained by title insurance agents of the affiliated and nonaffiliated agencies.

Fiscal Impact

During the 2006 Legislative Session, it was estimated by the state's Consensus Estimating Conference that similar legislation would have a recurring annual negative impact to the General Revenue Fund of \$11.3 million. A small portion of the reduced taxes will be offset by an increase in retaliatory taxes, which was accounted for in the last estimate. A common practice in state insurance taxation to equalize taxes, a retaliatory tax is imposed on a foreign insurer if the aggregate tax and fee burden of that insurer's home state exceeds the burden in the other state based on the same amount of premium writings.

The \$11.3 million estimate is based on 2004 Florida title insurance premiums, when property sales and prices were booming. It is probable that the real-estate market slow-down will have an impact on title insurance premiums. This is supported by the recent significant reductions in the forecasts of the state's documentary stamp tax collections for FY 2006-07 and FY 2007-08. If the amount of title insurance premiums falls, the impact of the proposed legislation should be smaller. Hopefully, the state's estimators can use the most current data possible and make adjustments for current conditions to arrive at the best fiscal impact estimate.

The 2006 estimate is also based on taxing 30% of premiums. While 30% is standard, the amount that is required to be retained by insurers varies from 30% to 40%.

Title Insurance Taxation Needs to Be Addressed Now

This issue has been the source of numerous disputes in both Florida and other states. In California, the State Board of Equalization (“SBE”) concluded that the premium retained by title insurance agents should not be included in the measure of “all income” of title insurance underwriters.

Now in California, the title agent and the underwriter enter into a contract whereby the title agent performs services in exchange for 90% of the premium and the underwriter agrees to issue the policy in exchange for 10% of the premium. Thus, the underwriter is only taxable on the 10% of the premiums it actually receives because it forgoes the remainder of the premium and this is the only amount it realizes in gross income.

While nine states have a title premium tax system similar to Florida’s current one, three have adopted a system similar to the one envisioned by the proposed legislation.

This proposed legislation is an improvement over some previous versions that reduced the tax rate to 0.6%. This didn’t address the real issue of being taxed only on receipts underwriters actually received. The current language makes it clear that insurers are not liable for taxes on the portion of the premium retained by agents.

Title insurance and the expenses that make up title insurance premiums are different from other forms of property and casualty insurance and it is now time for Florida’s insurance premium tax laws to reflect that distinction.

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Florida TaxWatch's research recommends productivity enhancements and explains the statewide impact of economic and tax and spend policies and practices on citizens and businesses. Florida TaxWatch has worked diligently and effectively to help state government shape responsible fiscal and public policy that adds value and benefit to taxpayers.

This diligence has yielded impressive results: in its first two decades alone, policymakers and government employees implemented three-fourths of Florida TaxWatch's cost-saving recommendations, saving the taxpayers of Florida more than \$6.2 billion -- approximately \$1,067 in added value for every Florida family, according to an independent assessment by Florida State University.

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