

IN THE CLAIMS COMMISSION OF THE STATE OF TENNESSEE
MIDDLE GRAND DIVISION
AT NASHVILLE

FILED
CLAIMS COMMISSION
CLERK'S OFFICE

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**Companion Property and Casualty Insurance Company; Companion
Commercial Insurance Company**
Claimants.

v.

State of Tennessee,
Defendant.

No. X20120824

ROBERT N. HIBBETT, Claims Commissioner, Middle Division, sitting as the
Trial Court of Record

SUMMARY JUDGMENT FOR THE CLAIMANTS

The Claimants seek refund of retaliatory taxes paid to the State of Tennessee. Assistant Attorney General Jonathan N. Wike represented the Defendant, State of Tennessee. Mr. G. Michael Yopp, Esq. and Mr. Christopher A. Wilson, Esq. represented the Claimants. Oral arguments on the motions for summary judgment were heard October 21, 2013. The transcript of the proceedings was filed November 20, 2013. The Claimants filed proposed findings of fact and conclusions of law on December 20, 2013. The State filed its proposed memorandum and order also on December 20, 2013.

TENNESSEE CLAIMS COMMISSION'S JURISDICTION

The Tennessee Claims Commission has exclusive jurisdiction over all “claims for the recovery of taxes collected or administered by the state, except any tax collected or administered by the commissioner of revenue and any unemployment insurance tax collected or administered by the commissioner of labor and workforce development.” Tenn. Code Ann. § 9-8-307(a)(1)(O). The retaliatory tax imposed by Tenn. Code Ann. § 56-4-218 is administered and collected by the Department of Commerce and Insurance (the “Department”). Payment under protest is a prerequisite for bringing an action for the recovery of any tax believed by the taxpayer to be unjust or illegal. Tenn. Code Ann. § 67-1-901. The claimant must file a claim with this Commission within six months of such payment under protest. Tenn. Code Ann. § 9-8-402(a)(3). All claims addressed herein are proceedings under this scheme for payment made under protest followed by filing claims in the Claims Commission for recovery of those taxes. The Claims Commission has jurisdiction of all claims addressed herein.

The parties have written outstanding proposed findings and conclusions of law. The Tribunal has incorporated copious amounts of those documents into this judgment.

THE UNDISPUTED FACTS

Claimants are South Carolina-domiciled corporations qualified to do business in Tennessee and authorized by the Department to offer insurance in Tennessee, including workers' compensation insurance. Claimants' complaint, filed on August 24, 2012, seeks a refund of retaliatory taxes paid under protest for the tax year 2011. Claimants challenge the Department's determination that assessments for the South Carolina Second Injury Fund must be included in the South Carolina burden for purposes of calculating their Tennessee retaliatory tax liability.

The State of Tennessee, through the Commissioner of Commerce and Insurance, is authorized to impose Tennessee insurance premium taxes on both Tennessee and foreign insurance companies writing insurance in Tennessee. Tenn. Code Ann. § 56-4-205. One of the taxes administered by the Department is a "retaliatory tax" that is levied only on foreign (out-of-state) insurance companies doing business in Tennessee where, by the law of any other state, the burden imposed upon Tennessee insurance companies doing business in such other state is in excess of the burden imposed upon foreign insurance companies doing business in Tennessee. Tenn. Code Ann. § 56-4-218. The Tennessee

retaliatory tax is imposed in an amount equal to the difference between (a) the taxes imposed by Tennessee upon a foreign insurance company doing business in Tennessee, and (b) the taxes that would be imposed upon a hypothetical Tennessee insurance company doing the same amount and type of business in the foreign insurer's home state. *Id.* For purposes of determining the retaliatory taxes due, the Department is required to compute “the burden of premium taxes on the basis of the basic premium tax rate levied by the laws of the other state.” Tenn. Code Ann. § 56-4-218(a).

When it audited Claimants’ gross premium tax returns for the tax year 2009, the Department determined that Claimants had not listed assessments for the South Carolina Second Injury Fund on Line 9 (Any Additional Tax, Fee or Obligation Subject to Retaliatory Tax) of Schedule D (Retaliatory Tax). The Department also ascertained that assessments for the South Carolina Second Injury Fund should be included among such additional taxes, fees, and other obligations. Using guidelines obtained from the South Carolina Second Injury Fund, the Department calculated the amount of the assessment for the Fund that would result from the amount of gross paid losses for Tennessee that each Claimant reported to the Department for 2008. The Department sent invoices to

each Claimant for the additional amount due that resulted from listing on Line 9 calculated using that Claimants' gross paid losses for Tennessee, and Claimants paid the invoiced amounts. Using the Department's method, each Claimant listed South Carolina Second Injury Fund assessments on its returns for the years 2010 and 2011 and paid the resulting tax liability. Claimants paid the 2011 liability under protest and filed this action for a refund of retaliatory taxes paid for 2011. Claimant Companion Property and Casualty Insurance Company paid \$613,860 in retaliatory tax under protest for 2011. Claimant Companion Commercial Insurance Company paid \$116,546 under protest for 2011. Those amounts are at issue in this claim.

SUMMARY JUDGMENT STANDARD

Both the Claimants and the State have filed motions for summary judgment. Rule 56 of the Tennessee Rules of Civil Procedure provides that summary judgment

shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue to any material fact and that the moving party is entitled to a judgment as a matter of law.

Both parties have agreed and the Tribunal finds that there is no genuine issue to any material fact. There are only questions of how to apply the undisputed facts to the law. Therefore, these claims are ripe for summary judgment.

CONCLUSIONS OF LAW

The parties have presented vigorous legal arguments to the Tribunal in support of their contentions. Tennessee retaliatory tax is set forth in Section 56-4-218(a) Code Annotated, which specifically provides as follows:

When, by the laws of any other state or foreign country, any premium or income or other taxes, or any fees, fines, penalties, licenses, deposit requirements or other obligations, prohibitions or restrictions are imposed upon Tennessee insurance companies doing business in the other state or foreign country, or upon their agents in the other state or foreign country, that are in excess of the taxes, fees, fines, penalties, licenses, deposit requirements or other obligations, prohibitions or restrictions imposed upon the insurance companies of the other state or foreign country doing business in this state, or that might seek to do business in this state, or upon their agents in the state, so long as the laws continue in force, the same premium or income or other taxes, or fees, fines, penalties, licenses, deposit requirements or other obligations, prohibitions and restrictions of whatever kind shall be imposed upon the companies of the other state or foreign country doing business in this state, or upon their agents in this state.

The Tennessee Supreme Court has long recognized that, in enacting the retaliatory tax, the General Assembly intended “to equalize the tax burden which

each state imposed by virtue of its sovereign authority to tax.” *Williams v. Thomas Jefferson Ins. Co.*, 385 S.W.2d 908, 910 (Tenn. 1965). The Tennessee Supreme Court in *Republic Ins. Co. v. Oakley*, 637 S.W.2d 448 (Tenn. 1982) reiterated that

[t]he legislative purpose of the retaliatory insurance tax statute, as noted above, is to protect Tennessee insurance companies by encouraging foreign jurisdictions not to impose heavier burdens on Tennessee companies than Tennessee imposes upon their companies who come here to do business. Inequality of tax burdens between Tennessee and other states . . . represents the mischief which T.C.A. § 56-423 [now codified at Tenn. Code Ann. § 56-4-218], was designed to eliminate. It is our duty to enforce that enactment to remedy the mischief, which it was designed to prevent. *Hilliard v. Park*, 212 Tenn. 588, 370 S.W.2d 829 (1963).
Republic Ins. Co. v. Oakley, 637 S.W.2d 448, 451 (Tenn. 1982).

The questions presented to the Tribunal are the following:

- (1) Whether Defendant, by and through the Commissioner of Commerce and Insurance, erroneously calculated the burden imposed by the South Carolina Second Injury Fund for retaliatory tax assessment purposes, in violation of Tenn. Code Ann. § 56-4-218 as well as the Equal Protection Clause and Due Process Clause of the United States Constitution.
- (2) Whether Defendant, by and through the Commissioner of Commerce and Insurance, erroneously failed to consider South Carolina Second

Injury Fund reimbursements in calculating the overall South Carolina Second Injury Fund burden imposed in violation of Tenn. Code Ann. § 56-4-218 as well as the Equal Protection Clause and Due Process Clause of the United States Constitution.

The parties in this case do not dispute that Tennessee retaliatory tax is based upon a comparison of the burden imposed upon Claimants by the laws of Tennessee against the burden that would be imposed under South Carolina law upon hypothetical Tennessee insurers doing the same volume of business in South Carolina as Claimants do in Tennessee. This Tribunal finds that such a comparison is mandated by Tennessee's retaliatory tax statute. There is no dispute that, pursuant to Tenn. Code Ann. § 56-4-218(a), Tennessee retaliatory tax only applies to the extent that, after comparing state burdens, the total tax burden the insurer's state of domicile imposes on a Tennessee insurer is greater than the burden Tennessee imposes on the foreign insurer.

Tennessee imposes premiums tax at a rate of four percent (4%). Up to fifty percent (50%) of the four percent may be allocated to fund Tennessee's Second Injury Fund. Tenn. Code Ann. §§ 50-6-401 and 50-6-208. However, South Carolina Second Injury Fund assessments do not constitute a classic tax imposed

pursuant to a set rate. Rather, such assessments cumulatively constitute a finite sum, representing a recouplement of prior-year South Carolina Second Injury Fund reimbursements paid out to insurance companies with eligible claims, which is allocated among all insurance companies operating within South Carolina, based upon the proportion of a company's normalized premiums to total normalized premiums of all insurance companies operating in South Carolina. *See* S.C. Code Ann. § 42-7-310.

In accordance with S.C. Code Ann. § 42-7-310, a South Carolina Second Injury Fund assessment for a Fictional Tennessee Company must be determined as follows:

(i) Total prior-year reimbursements of all carriers paid from the South Carolina Second Injury Fund are multiplied by 135%;

(ii) Direct losses, reduced by reimbursements received from the South Carolina Second Injury Fund, for each insurance company operating in South Carolina are multiplied by the normalized expense factor to determine such insurance company's individual normalized premium;

(iii) An effective assessment rate is determined by dividing 135% of the prior-year reimbursements paid by the South Carolina Second Injury Fund by

the total normalized premiums of all insurance companies operating in South Carolina; and

(iv) The effective assessment rate is multiplied by each individual insurance company's normalized premium to determine such company's assessment amount.

S.C. Code Ann. § 42-7-310.

Thus, a South Carolina Second Injury Fund effective assessment rate is determined by dividing (1) the prior year reimbursements by the South Carolina South Injury Fund for the applicable period, which forms the basis for the numerator of the applicable equation, by (2) the total normalized premiums of all insurance companies operating in South Carolina—calculated based upon the amount of premiums written by insurance companies operating in South Carolina—which forms the basis for the denominator of the applicable equation.

Id. By the indisputable laws of mathematics, either the addition of any amount to the numerator or denominator of this equation results in changing the South Carolina Second Injury Fund effective assessment rate.

In assessing Tennessee retaliatory tax, Claimants assert that Defendant determined the South Carolina Second Injury Fund burden for hypothetical

companies doing the same volume of business in South Carolina as Plaintiffs do in Tennessee by relying upon a South Carolina Second Injury Fund effective assessment rate calculated without the inclusion or consideration of (1) South Carolina Second Injury Fund reimbursements allocable to hypothetical companies with the same volume of business in South Carolina as Claimants have in Tennessee, (2) direct losses attributable to such hypothetical companies, as determined pursuant to S.C. Code Ann. § 42-7-310, or (3) the inclusion of any South Carolina Second Injury Fund reimbursements allocable to hypothetical companies in the determination of direct losses attributable to said hypothetical companies. Defendant does not dispute that such figures were excluded in the calculation of Claimants' Tennessee retaliatory tax assessments.

However, it is clear to the Tribunal, that, pursuant to South Carolina law, when hypothetical similar companies are deemed to be present within South Carolina, as required for purposes of determining retaliatory tax, gross paid losses and South Carolina Second Injury Fund reimbursements attributable to such entities must be included in the calculation of the South Carolina Second Injury Fund effective assessment rate. Indeed, neither the normalized premiums nor an effective assessment rate can be determined without considering South

Carolina Second Injury Fund reimbursements received by all insurance companies operating in South Carolina – which necessarily includes hypothetical companies. Furthermore, an accurate determination of a South Carolina Second Injury Fund effective assessment rate in a “hypothetical world,” in which the South Carolina Second Injury Fund burden must be determined for retaliatory tax purposes, requires that any direct losses or South Carolina Second Injury Fund reimbursements attributable to hypothetically similar companies to other South Carolina insurance companies against which Tennessee or other states impose retaliatory tax must also be considered.

Defendant acknowledges that South Carolina Second Injury Fund effective assessment rates change from year to year because of fluctuations in the applicable factors. However, Defendant asserts that although it is a different rate each year, it is a fixed rate for any company. This overlooks the fact that, pursuant to South Carolina law, the effective assessment rate itself is variable dependent upon the gross paid losses and Second Injury Fund reimbursements received by all insurance providers operating within South Carolina. *See* Transcript, p. 54, lns. 12-19. Thus, the addition of new gross paid loss or reimbursement factors attributable to a hypothetical company being added

results in a different effective assessment rate. While the Tennessee Supreme Court held in *Republic* at 450, that “a determination whether or not retaliatory taxes are called for is to be based solely upon a comparison of the *basic tax rate* of the two states in question,” the language set forth in Tenn. Code Ann. § 56-4-218(a) plainly and unambiguously mandates that competing burdens imposed by states be determined pursuant to the applicable law of each respective state using hypothetically similar companies.

By failing to incorporate direct losses and South Carolina Second Injury Fund reimbursements attributable to hypothetical companies in its calculation of South Carolina Second Injury Fund assessments, Defendant in effect seeks to transform South Carolina Second Injury Fund assessments into a traditional tax which does not exist. Unlike proceeds derived from a traditional tax, which increase with the presence of new taxpayers, the overall South Carolina Second Injury Fund burden imposed is finite and is merely allocated and divided among insurers operating within South Carolina. The mere presence of additional insurers does not increase the finite burden that is allocated—that burden is determined based upon prior year South Carolina Second Injury Fund reimbursements, which are a definite and fixed amount.

Defendant's requirement that the South Carolina Second Injury Fund burden upon the Fictional Tennessee Companies be determined with no consideration of the impact of additional gross losses or South Carolina Second Injury Fund reimbursements attributable to hypothetical companies is contrary to South Carolina law and results in an arbitrary comparison of Tennessee and South Carolina burdens in clear contravention to Tenn. Code Ann. § 56-4-218. To be succinct, South Carolina's method of funding its Second Injury Fund, as a matter of law, is not a tax and should not be construed as a tax. While the Commissioner of Commerce and Insurance has discretion in interpreting and applying Tennessee's retaliatory tax scheme, the Tennessee Supreme Court has long held that "the rule of giving great weight to administrative interpretation is not applicable where the language of the statute is plain and the meaning is obviously different from the administrative construction." *Covington Pike Toyota v. Cardwell*, 829 S.W.2d 132, 134 (Tenn. 1992).

Claimants contend that, in determining the overall net burden imposed by the South Carolina Second Injury Fund, Defendant further failed to properly consider South Carolina Second Injury Fund reimbursements. Defendant has admitted through counsel that Defendant "didn't take those reimbursements into

consideration.” Transcript, p. 66, Ins. 3-6. The Tribunal disagrees with Defendant’s actions in this regard and finds that the logic behind Claimant’s assertion is obvious—if an insurer is allocated and pays \$1,000,000 in Second Injury Fund assessments, but receives \$1,100,000 in South Carolina Second Injury Fund reimbursements back, the net burden imposed through this cyclical flow of funds equals less than zero. The undisputed facts establish that Claimants’ own South Carolina experience mimic this hypothetical since Claimants have for over the past ten years paid less in South Carolina Second Injury Fund assessments than they receive in reimbursements, resulting in no net burden. In this claim, the practical application of the statutory law matters.

Despite Defendant’s assertions otherwise, South Carolina Second Injury Fund reimbursements are distinguishable from the premium tax credits for in-state investments addressed by the Tennessee Supreme Court in *Williams v. Thomas Jefferson Insurance Co.* and *Republic Insurance Co. v. Oakley*. These cases dealt with the interaction between statutes providing premium tax credits for in-state investments and the application of the retaliatory tax. Specifically, for Tennessee retaliatory tax comparison purposes, the taxpayer in *Republic* sought to reduce the premium tax burden imposed by Texas, its home state, through the

use of a credit received for such taxpayers' investments in Texas property and securities. *Republic*, 637 S.W.2d at 449-50. Rejecting the taxpayers' argument, the Tennessee Supreme Court recognized that the taking of a Texas investment credit was optional and further cited out-of-state case law for the premise that a "tax burden comparison" for retaliatory tax purposes did not require a presumption that "similar insurers" would make the same level of in-state investments so as to qualify for an investment credit. *Id.* at 451-53.

Unlike the premium tax regime addressed in *Republic* and *Williams*, the South Carolina Second Injury Fund constitutes an insurance system through which funds flow to and from insurance companies operating in South Carolina in a cyclical manner via mandatory reimbursements for qualifying injuries followed by a subsequent allocation among South Carolina insurers of a sum, determined based upon the total amount of reimbursements for the previous year, in order to make the fund whole. S.C. Code Ann. §§ 42-7-310 and 42-9-400(a). The mandatory South Carolina Second Injury Fund reimbursements constitute a crucial part of the South Carolina Second Injury Fund system, without which the system fails to function, whereas the investment tax credit addressed in *Republic* constituted an economic development incentive, separate

and apart from the premium tax, which was designed to encourage taxpayers to increase their level of investment within the state. Obviously, a burden is imposed to the extent that an insurance company receives less in reimbursements than what it pays in assessments. However, the undisputed facts establish that, as a result of this cyclical flow of funds, such is not the case with regard to Claimants.

Based upon the undisputed facts in this case, the Tribunal finds that Defendant has clearly miscalculated the burden imposed by the South Carolina Second Injury Fund, and the arbitrary comparison of South Carolina and Tennessee burdens utilized by Defendant in this case runs afoul of the requirements of Tenn. Code Ann. § 56-4-218(a) that retaliatory tax apply only where the actual burden imposed by another state actually exceeds that imposed in Tennessee, and further runs afoul of the legislative intent behind the tax, as recognized by the Tennessee Supreme Court in *Williams* and *Republic*, to equalize tax burdens imposed by competing states. *Williams*, 385 S.W.3d at 910; *Republic*, 637 S.W.2d at 451.

Because the Tribunal finds that the Department of Commerce and Insurance has violated the legislative intent of the Tennessee General Assembly

in the method it has assessed retaliatory taxes against the Claimants, there is no need to address the issues of Due Process or Equal Protection under the United States Constitution.

SUMMARY

In this case, the Department of Commerce and Insurance imposed Tennessee retaliatory tax against Plaintiffs on the basis that the South Carolina Second Injury Fund imposes a greater burden than that imposed by Tennessee. Indeed, as previously discussed, a comparison of state tax burdens is necessary in determining whether the imposition of Tennessee retaliatory tax is appropriate. However, the Department of Commerce and Insurance's imposition of retaliatory tax against Claimants in this case clearly constitutes an erroneous assessment of the tax. Neither the South Carolina Second Injury Fund assessment amounts, nor the net burdens attributable thereto, calculated for Tennessee retaliatory tax purposes were determined in accordance with applicable Tennessee and South Carolina law. The Department of Commerce and Insurance's reliance upon an erroneous determination of the South Carolina Second Injury Fund burden to assess Tennessee retaliatory tax unfairly and unjustifiably results in the imposition of a higher tax burden upon Claimants in

violation of Tennessee law as enacted by the Tennessee General Assembly under Tenn. Code Ann. § 56-4-218.

Therefore, summary judgment is rendered on behalf of Claimants on all claims raised. Conversely, Defendant's motion for summary judgment is respectfully denied.

IT IS, THEREFORE, ORDERED, ADJUDGED AND DECREED:

1. That Summary Judgment is granted to Claimants and the claims against the State of Tennessee for refund of retaliatory taxes paid are granted.
2. That Defendant's Motion for Summary Judgment is denied.
3. That the costs, if any, are taxed to Defendant.
4. This is a Final Judgment for the purposes of appeal.

ENTERED this 13 day of February 2014.

A handwritten signature in black ink, appearing to read 'R. N. Hibbett', is written over a horizontal line. The signature is stylized and cursive.

ROBERT N. HIBBETT
Claims Commissioner
Sitting as the Trial Court of Record

CERTIFICATE OF SERVICE

This is to certify that a true and exact copy of the foregoing document has been served upon the following parties of record:

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This 19 day of Feb., 2014.



PAULA SWANSON
Administrative Clerk
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