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## FISCAL IMPACT REPORT

SPONSOR HTRC ORIGINAL DATE 2/13/18  
 LAST UPDATED 2/14/18 HB 223/HTRCS

SHORT TITLE Insurance Premium Tax Collection Transfer SB \_\_\_\_\_

ANALYST Romero/Martinez/Clark

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY18	FY19	FY20	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
		\$595.0		Recurring	Insurance Premium Fund Revenues (TRD)
		(\$595.0)		Recurring	Insurance Premium Funds Revenues (OSI)

(Parenthesis ( ) Indicate Expenditure Decreases)

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Office of Superintendent of Insurance  
 Taxation and Revenue Department  
 Administrative Hearings Office

### SUMMARY

#### Synopsis of Bill

House Bill 223 transfers the duty to collect insurance premium taxes to the Taxation and Revenue Department (TRD) including personnel, appropriations, property, contractual obligations and rules beginning January 1, 2020. HTRC Sub for HB 223 repeals sections of current law and enacts similar sections under the Tax Administration Act for oversight by TRD.

### FISCAL IMPLICATIONS

TRD will need additional resources to administer the tax program, although perhaps less than OSI needed due to efficiencies of scale at TRD. Since TRD performs other tax program administration, collection, and auditing functions, there should be savings on staff and equipment compared with what is needed at OSI. The Office of the Superintendent of Insurance currently

has 6 FTE in the financial audit bureau responsible for premium tax collection. The total FY19 request for this bureau, including personal services and employee benefits, contractual services, and other costs is \$595 thousand. This bill will require the Office of the Superintendent of Insurance to transfer \$595 thousand of insurance premium tax revenues to the Taxation and Revenue Department to cover all costs of the 6 FTE. The current information provided by both TRD and OSI shows that this funding amount will be adequate to complete the transfer. TRD Analysis of HB223 is attached but does not provide detail of the work conducted over the past year in partnership with OSI.

### **SIGNIFICANT ISSUES**

This bill improves tax policy by moving insurance tax collection to the Taxation and Revenue Department, organized to collect taxes for the state, and away from the insurance industry's regulator – the Office of Superintendent of Insurance. Placing the regulator for the industry in charge of collecting the taxes while members of the industry sit on the board that appoints the superintendent of insurance and determines his or her salary is fraught with the appearance of conflicts of interest. The agency collecting these taxes should have a director whose salary is unaffected by the actions and desires of the insurance industry. This transfer of tax collection authority will also leave OSI free to focus on regulatory issues, which seems to be the agency's core competency.

LFC staff have raised possible concerns to OSI for years, even prior to the agency splitting off from the Public Regulation Commission, about the agency's ability to properly administer and audit this tax program. The recent conclusion of the special audit of premium tax revenues that insurance companies underpaid their taxes by a total of \$65 million over more than a decade illustrates the challenges OSI faced in collecting revenues and ensuring taxes were paid appropriately.

In the premium tax program's infancy, when the industry was smaller and revenues were less, perhaps these considerations were not as important. However, insurance revenues distributed to the general fund were \$235 million in FY17, making the program one of the single largest tax programs in the state and representing nearly 4 percent of all general fund revenues.

Through partnership and oversight with the Office of the State Auditor (OSA), Department of Finance and Administration, and the Legislative Finance Committee, OSI issued a request for proposal seeking an independent, external auditor with experience in premium tax examination to review the New Mexico process and statutes for payments, and examine taxpayer returns dating back to 2003. After reviewing several respondents' proposals, the OSA selected Examination Resources, an Atlanta-based firm, to conduct the 30 examinations for the OSI.

In October 2017, the State Auditor along with Examination Resources released the special audit of the Office of the Superintendent of Insurance's collection of premium taxes. Of the 30 companies, 2 were Medicaid only and not subject to premium tax collection, 11 either did not owe the state money or the state underpaid. The audit found the remaining 17 companies owe \$65 million to the state. Companies with the largest amounts owed are Presbyterian Health Plan, \$28.9 million; HSC Mutual (Blue Cross Blue Shield Mutual Reserve), \$8.4 million; Molina Healthcare, \$8.1 million; Amerigroup, \$6.9 million; United Healthcare, \$3.8 million; and Lovelace, \$3.8 million.

Due to the severity of the state's financial situation, with \$65 million in revenue expected from under-collected premium taxes, the Legislative Finance Committee, Department of Finance and Administration, Taxation and Revenue Department, and the Office of Superintendent of Insurance support moving insurance tax collection to the Taxation and Revenue Department.

The Administrative Hearings Office provided the following:

“Because this bill moves the collection of insurance premium tax from OSI to the TRD pursuant to the Tax Administration Act, an insurance company will have the ability to protest any collection action under Section 7-1-24 NMSA 1978 of the Tax Administration Act. Any protest under that section would entitle the protesting insurance company to an administrative hearing before the Administrative Hearings Office (AHO) pursuant to Section 7-1B-8 NMSA 1978 of the Administrative Hearings Office Act. This bill is likely to increase the tax protest case load of AHO, which is already stretched thin with the tax docket. Any such protest hearing would likely be a complex and litigious adjudication in a new area of law for TRD and new area of adjudication for AHO, thus consuming far more time than a usual tax protest proceeding. Although it is unclear how many administrative hearings might result from collection of insurance premiums (OSI and LFC likely have a more accurate historical data that can be used to estimate this case load), out of an abundance of caution, AHO estimates that an additional hearing officer position may be required.”

#### **ADMINISTRATIVE IMPLICATIONS**

The Taxation and Revenue Department and the Office of Superintendent of Insurance will begin testing data and software in April 2018. At this time, OSI will begin using a new software for collection of premium tax, allowing both parties to test efficiencies before the effective date of HB223.

Given the current staffing resources of AHO in conducting tax hearings, it is unlikely that AHO will be able to efficiently adjudicate more than a handful of these new hearings and other tax hearings in an efficient manner without an additional hearing officer position.

#### **ALTERNATIVES**

##### **The following alternatives were provided by the Office of Superintendent of Insurance:**

Failure to transfer the premium, surtax, and surplus lines tax collection function from OSI to TRD will require 7 to 8 additional FTE at OSI beginning in fiscal year 2020. This level of staffing will be required to effectively collect taxes and perform necessary audit functions as well as maintain a separation between the two functions.

OSI is in the process of implementing the recommendations of the special audit firm, Examination Resources, Inc. Which describes the lack of staff as a reason for the failure to properly collect and audit premium taxes correctly in past years. This sentiment has also been expressed by the Office of the State Auditor during its yearly financial audits; Clifton, Larson Allen, the accounting firm that performed that first premium tax review; and the Taxation and Revenue Department as a part of its requirements of the transfer of this function to that department.

## TECHNICAL ISSUES

TRD provided the following technical issues:

“There needs to be a Provision stating the Insurance Premium Tax Act shall be governed by the Tax Administration Act as stated in NMSA 1978, § 7-1-2.

Page 6, Section 4 – Reciprocity provision is in direct violation of NMSA 1978, Section 7-1-8; however, if the Insurance Premium Tax Act is not subject to the Tax Administration Act, there would be no violation of confidentiality by sharing tax information.

Page 11, Section 8 – Penalty – The penalty is \$1,000.00 per month. If TRD is going to administer the Insurance Premium Tax Act, insurers should be subject to the Tax Administration Act of penalty under NMSA 1978, Section 7-1-69

Page 11-13, Section 8 – Penalty – requirements are confusing for service of process

Page 13, Section 9 – Refunds – Why is the money continuing to go to the “insurance department suspense fund?” If TRD will be collecting the premium taxes, the money should be going to the tax department suspense fund. Why would TRD authorize money to be refunded from the insurance department suspense fund? This refund claim period is only 3 years from the date of the erroneous payment.

Page 14, Section 10 – “shall” should be changed to “may”

Page 60, Section 30 – Part A – This needs to state as follows: “On the effective date of this act, only the 5-7 FTE personnel directly involved with ....”

## WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The state is risking a loss of revenue for the general fund from premium tax collection, as the current method with the Office of the Superintendent of Insurance has proved to be inefficient. This is still a concern with an effective date of January 1, 2020, allowing almost two more years of premium tax collection to be administered by the Office of Superintendent of Insurance.

JM/JC/IR/jle/al