STATE OF MAINE

REPORT

OF THE

ATTORNEY GENERAL

For the Years
1967 through 1972

The price established for licensee purchases may, for example, be the same as or more than the retail price established for other than licensee purchases. Under the language of the amendment, it could be the same retail price as that established in all other retail stores. It could not be more. In short, the Legislature has left the matter of licensee discount pricing at one store up to the Commission, and the Commissioner of Finance and Administration, within established guidelines. Too, although the provision "may . . . establish . . . " can be read to reach an opposite result, we believe that once reduced prices are established at one store, a price must likewise be established to which the licensee discount is applicable.

JON R. DOYLE
Deputy Attorney General

August 9, 1971
Bureau of Taxation

To: Ernest H. Johnson, State Tax Assessor

Subject: The Gross Direct Premium Tax As Applied To A Special Contractual Insurance Arrangement

SYLLABUS:

THE ENTIRE SUM RECEIVED ANNUALLY BY A DOMESTIC INSURANCE COMPANY, IS A GROSS DIRECT PREMIUM AND IS TAXABLE AS SUCH, LESS RETURN PREMIUMS AND DIVIDENDS, UNDER THE PROVISIONS OF 36 M.R.S.A. §2511 WHEN THE SUM IS RECEIVED PURSUANT TO A SPECIAL CONTRACTUAL ARRANGEMENT WHEREBY A PORTION OF THE SUM RECEIVED IS COMPENSATION TO THE INSURANCE COMPANY FOR HANDLING OF THE INSURED CORPORATION'S LOSS CLAIMS AND THE BALANCE OF THE SUM RECEIVED IS PLACED IN A SPECIAL "LOSS FUND ACCOUNT" IN A BANK OR TRUST COMPANY FROM WHICH ACCOUNT THE INSURANCE COMPANY PAYS THE INSURED CORPORATION'S COVERED LOSSES.

FACTS:

There is proposed to be organized in the State of Maine an insurance company, which plans to enter into contracts with a number of large corporations. Pursuant to these contracts a corporation would turn over to the insurance company annually a substantial sum of money for payment of indemnity claims against the corporation and for compensation to the insurance company for the processing of the claims. The sums of money turned over to the insurance company would pursuant to a Loss Fund Agreement less the agreed upon compensation be turned over immediately by the insurance company to a bank or trust company and placed in a special trust account in the bank or trust company hereinafter referred to as the Loss Fund. From the Loss Fund claims against the insured corporation would be paid by the insurance company. The Loss Fund Agreement would provide inter alia, that the insurance company would have no right, claim or interest in the principal or income of the Loss Fund. Also, payments would be made out of the Loss Fund only to or for the account of the insured; no portion of the principal or income of the Fund would be paid to the insurance company for its own account.

In addition it has been submitted that the amount paid in annually by the insured corporation is deductible by the insured corporation as an insurance premium expense for federal income tax purposes. All interest from the Loss Fund belongs to the insured corporation and it is also intended that the bank would provide a line of credit to the insured corporation for the difference between the commencement amount of the Loss Fund and the agreed total amount of the Loss Fund. (For supporting and additional information, see attached material.) It is also understood that all such insurance contracts between the insurance company and an insured corporation will be delivered by the insurance company to the insured corporation in the State of Maine. The State of Maine Insurance Department has concluded that the proposed contracts are insurance contracts and would be subject to regulation by that department.

QUESTION:

Should the sum paid by the insured corporation, or only the percentage of that sum to which the insurance company is entitled as compensation for its activities, be considered as a taxable premium within the scope of 36 M.R.S.A. § 2511 through 2552?

ANSWER:

Both the sum deposited in the Loss Fund and the percentage of that sum to which the insurance company is entitled as compensation for its activities are taxable as gross direct premium.

REASONS:

The Maine Insurance Code defines insurance as follows:

> " 'Insurance' is a contract whereby one undertakes to pay or indemnify another as to loss from certain specified contingencies or perils, or to pay or grant a specified amount or determinable benefit or annuity in connection with ascertainable risk contingencies, or to act as surety." 24-A M.R.S.A. § 3

This opinion is based on the conclusion of the insurance department that the proposed contracts are insurance and fall within the statutory definition of insurance. It should be noted that the proposed contract differs inter alia from most insurance contracts in that under the proposed contract all losses to an insured will be paid entirely from sums furnished by that insured. Typically with insurance contracts there is a spreading of the risk so that losses are paid from premiums provided in part by other insureds.

Title 24-A of the Maine Revised Statutes in the Maine Insurance Code. Chapter 27 of Title 24-A is a chapter whose scope is set forth in § 2401. This section reads as follows:

> "This chapter applies as to all insurance contracts and annuity contracts, other than:
>
> 1. Reinsurance.
>
> 2. Policies or contracts not issued for delivery in this State nor delivered in this State.
>
> 3. Wet marine and transportation insurance." 24-A M.R.S.A. § 2401

Chapter 27 applies to the proposed insurance contracts as they are not contracts of reinsurance, they are contracts to be delivered in the State and are not, on the basis of the facts provided, wet marine and transportation insurance.

2403 of Chapter 27 of Title 24-A defines premium as follows:

" 'Premium' is the consideration for insurance, by whatever name called. Any 'assessment', or any 'membership', 'policy', 'survey', 'inspection', 'service' or similar fee or other charge in consideration for an insurance contract is deemed part of the premium."

The compensation to the insurance company provided by the insurance contract, which is compensation deducted from the sum turned over to the insurance company by the insured corporation prior to the deposit of the balance of that sum in the Loss Fund in the bank or trust company, clearly is a fee contemplated by the second sentence of 24-A M.R.S.A. § 2403. This being so, can this compensation be the entire premium? We conclude it cannot. As the statute specifically says that such a fee is "deemed part of the premium" a part cannot be considered the entire premium. The premium is the consideration for insurance by whatever name called.

The pertinent taxing provision is 36 M.R.S.A. § 2511. The first sentence of this section relates to the taxation of domestic life insurance companies or associations. The second sentence of 36 M.R.S.A. § 2511 relates to the premium tax upon other domestic insurance companies or associations. The proposed insurance company would be subject to the tax imposed in the second sentence. The second sentence reads as follows:

"Every other insurance company or associations organized under the laws of this State, except those mentioned in section 2517, including surety companies and companies engaged in the business of credit insurance or title insurance shall annually pay a tax of 1% upon all *gross direct premiums* written whether in cash or in notes absolutely payable on contracts made in the State for fire, casualty and other risks, less return premiums thereon and less all dividends paid to policyholders and less all premiums and assessments on policies of insurance issued on farm property."

The tax is based on the gross direct premiums less return premiums and dividends paid to policyholders. The word "direct" is used to signify the situation of premium paid by an insured to an insurer as distinguished from a reinsurance situation whereby one insurer assumes part of the risk of another insurer in consideration for a premium paid by the first insurer to the reinsurer. This latter premium is not a direct premium.

In discussing the distinction between "net premium" and "gross premium" a leading treatise on insurance states:

"The part of the premium intended to meet the cost of insurance, both current and future, and carry it from period to period, is called the 'net premium'; it is the sum paid periodically by each to furnish the stipulated protection for all. In addition to this amount, the policyholders also pay what is known as a 'loading' rate, which is a sum added to the net premiums for administration, management, and operating expenses, as well as for emergency purposes, and, in some cases, profits. And this sum, added to the 'net premium', creates what is known as the 'gross premium.' " Vol. 5 *Couch on Insurance* 2d p. 506

While it is true that the above discussion is based on life insurance cases wherein the sum paid by each insured may be used to pay the beneficiaries of another insured as distinguished from a fact situation whereby the sum paid by each insured is segregated in a special fund and used to cover losses of that insured alone and no other insured, the underlying analysis of what constitutes a gross premium is valid.

The money placed by the insurance company pursuant to the Loss Fund Agreement in a Loss Fund in a bank or trust company is the part of the premium intended to cover the risk of the covered losses, and when and if pursuant to the Loss Fund Agreement, the insured corporation receives a portion of the funds deposited in the Loss Fund the receipt by the insured corporation is a return of premium for which the proper

adjustment in the taxable base must be made.

In further support of the conclusion that the entire sum paid by the insured corporation to the insurance company is a gross direct premium, we understand that the corporate insureds are to be advised that the entire sum paid in annually by them to the insurance company is deductible as an insurance premium expense for federal income tax purposes which enables them to build funds on a pre-tax basis and when any of the funds on deposit in the Loss Fund are returned to the corporate insured the returned funds will be treated as taxable income.

In addition reference is made to the July 28, 1971 letter of Keith Brown, Esquire of LeBoeuf, Lamb, Leiby & MacRae (see attached material), when in writing about the proposed insurance company at the suggestion of Mr. Michael Clement, Vice President of North Star Reinsurance Corporation, he states in pertinent part:

> "All *premiums* received by that company less 5% will immediately be paid over to a provisional bank or trust company and held by it for the benefit of the insured making any premium payment pursuant to a Loss Fund Agreement." (Emphasis supplied)

Certainly such language is consistent with the position that the sums received by the insurance company from an insured corporation would be deductible as a premium expense, we also believe such language to be consistent with the conclusion that such premiums are gross premiums and are taxable at the rate of 1% after the necessary adjustment for return of premiums.

JEROME S. MATUS

August 19, 1971
E.I.C.

William R. Adams, Director

Questions concerning Me. Public Laws 1971, c. 535

SYLLABUS:

The mandatory shoreland areas zoning requirements of Me. Public Laws 1971, c. 535, apply within 250 feet of the normal high water mark of all navigable flowing bodies of water in the State.

Whether a body of water is "navigable" is a question of fact for administrative determination in the first instance.

FACTS:

By memo you have asked the following questions regarding interpretation of Me. Public Laws 1971, c. 535.

QUESTION NO. 1:

The subject law defines the term "shoreland areas" as "those land areas any part of which are within 250 feet of the normal high water mark of any navigable pond, lake, river or salt water body . . . " can the word "river" be construed to include brooks and streams?