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Minnesota Revenue Department Issues Notice on Surplus Lines Insurance Taxation

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The Minnesota Department of Revenue recently published a revenue notice to clarify how brokers of surplus lines insurance policies should calculate the total amount of insurance premiums that are subject to taxation, addressing a statutory and regulatory ambiguity that has existed since 2010.

Under Minnesota law, surplus lines insurance brokers are responsible for paying tax on the "gross premium" of each insurance policy they place. In 2010, the Minnesota Legislature amended the definition of "gross premium" to include broker placement fees for purposes of surplus lines taxation. See, Minn. Stat. § 297I.05, subd. 9(d). The legislature's intent was to capture, as part of the gross premium, the fee a broker received as compensation for surplus lines policies placed net of commission. In other words, the legislature wanted the "gross premium" of a surplus lines insurance policy to include broker compensation when the broker was paid a separate fee and did not receive a standard commission.

Implementing this law change was difficult for the Department of Revenue and surplus lines brokers. The statute provided no guidance on how to allocate the broker's fee. This was problematic for many brokers because broker fees are paid for many activities other than placing surplus lines insurance policies. For instance, if a broker was paid $100,000 to place 20 different policies, only one of which was a surplus lines policy, and also to provide risk management advisory and other non-placement services, how much of the fee should be attributed to calculating the gross premium for the surplus lines policy? Governing statutes were silent, and many brokers believed existing guidance from the Department of Revenue was inadequate.

The Department of Revenue sought to resolve this ambiguity with Revenue Notice 20-01. The recently-published Revenue Notice sets forth three ways that a broker can report the portion of its fee as "gross premium":

1. The entire fee can be reported as gross premium.
2. A broker can determine the average commission received on its commissioned nonadmitted policies and then apply that commission rate to the premium on policies sold net and then report the corresponding amount as gross premium.
3. A broker apply the average industry surplus lines commission reported on the Minnesota NAIC annual statutory statement (currently 14.97%) to the premium on policies sold net and then report the corresponding amount as gross premium. The Department of Revenue will update this percentage annually.

A broker that uses one of these three methods will be in compliance with Minnesota's surplus lines tax law. These methods provide taxpayers with some measure of certainty in how to report fee income as taxable gross premium that will be accepted by the Department of Revenue.

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