

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 15375
[REDACTED],	)	
	)	DECISION
Petitioner.	)	
	)	
	)	

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On January 8, 2001, the Income Tax Audit Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (the “taxpayer”), denying claimed tax refunds of \$3,827 for tax year ending 6/30/98 and \$6,202 for tax year ending 6/30/99 and proposing additional income tax, penalty, and interest for tax year ending 6/30/2000 in the total amount of \$12,480.

On February 2, 2001, a timely protest and petition for redetermination was filed by the taxpayer. An informal conference was requested by the taxpayer and held on April 24, 2001 and an additional meeting with taxpayer’s counsel was held on May 10, 2001.

The Tax Commission has reviewed the file, is advised of its contents, and hereby issues its decision modifying the Notice of Deficiency Determination. The issue for decision is the application of Idaho Code § 41-405 to the income taxation of a corporation that is an insurance agent. The Tax Commission holds that I.C. § 41-405 does not exempt insurance agents from Idaho income taxation. The modification relates to penalty only.

**Facts**

The taxpayer is a corporation and it is a licensed resident insurance agent for insurers that are authorized to transact insurance in Idaho. Typically, the taxpayer collects initial premiums for such insurers, who then pay the premiums tax to the Idaho Department of Insurance on the gross amount of premiums and remit commissions to the taxpayer.

The taxpayer has paid Idaho income taxes for all three of the tax years at issue. The taxpayer requested refunds on amended returns for years ending in 1998 and 1999.

Under the Surplus Line Law, Idaho Code § 41-1211 *et seq.*, the Idaho Department of Insurance allows about 60 or 70 insurance companies that are not admitted or authorized in Idaho to write insurance on Idaho risks. Nonadmitted insurers tend to underwrite low volumes of specific risks on a one-time basis; the Code requires that such coverages not be procurable from authorized insurers, or that the market for such coverages in Idaho is not adequate. Such policies are referred to in the trade as surplus lines.

There is a privately owned “surplus line association” in Idaho. See I.C. § 41-1214(1). An agent who writes a surplus lines policy files it with the association, which charges a fee and verifies that the insurer is on the approved list of the Department of Insurance. The agent collects the premium, the association’s fee and the Idaho premiums tax from the insured, and remits the tax annually to the Department of Insurance. The agent withholds his or her commission and remits the net premium to the insurer.

Individual agents employed by the taxpayer performed the functions just described with respect to surplus lines during the tax years in dispute. They paid individual income taxes in the normal manner.

The taxpayer does not claim to be an insurer with respect to its regular business with admitted insurers, or its agents’ surplus lines business.

## **Law and Analysis**

### Statutory Scheme

The Idaho premiums tax is imposed by Chapter 4 of Title 41 of the Idaho Code. Section 41-402 requires authorized insurers to file statements with, and pay the premiums tax to, the

Department of Insurance. As to surplus lines, § 41-1229 requires “brokers” to collect, file and remit tax annually.

Section 41-405 provides in full as follows:

**41-405. PREMIUM TAX IN LIEU OF OTHER TAXES – LOCAL TAXES PROHIBITED.**

(1) Payment to the director by an insurer of the tax upon its premiums as in this chapter required, shall be in lieu of all other taxes upon premiums, taxes upon income, franchise or other taxes measured by income, and upon the personal property of the insurer and the shares of stock or assets thereof; provided, that all real property, if any, of the insurer shall be listed, assessed and taxed the same as real property of like character of individuals.

(2) The state of Idaho hereby preempts the field of imposing excise, privilege, franchise, income, license, permit, registration, and similar taxes, licenses and fees upon insurers and their agents and other representatives as such; and no county, city, municipality, district, or other political subdivision or agency in this state shall levy upon insurers, or upon their agents and representatives as such, any such tax, license or fee; nor shall any such county, city, municipality, district, political subdivision or agency require of any such insurer, agent or representative, duly authorized or licensed as such under this code, any additional authorization, license, or permit of any kind for conducting therein transactions otherwise lawful under the authority or license granted under this code.

Taxpayer’s Two Arguments

The taxpayer first claims that subsection (2) prevents the Tax Commission from imposing or collecting income taxes from insurance agents such as itself, and from its employees when acting as brokers for surplus lines. The taxpayer first argues that it and its employees are “agents and other representatives” of insurers within the meaning of that subsection. The Tax Commission agrees with that characterization.

The taxpayer next argues that by subsection (2), the State has preempted and prohibited the imposition of various taxes, including income taxes, upon agents and other representatives, by listed units of local government and “other . . . agenc[ies] in this state.” The State Tax Commission, being an agency in this state, falls within the preemption. The taxpayer’s conclusion is that income taxes upon agents and representatives of insurers are prohibited. The

foregoing is referred to below as the taxpayer's subsection (2) argument.

The taxpayer alternatively argues, under subsection (1), that payment of premiums tax by an insurer is "in lieu of all . . . taxes upon income," without limitation to income taxes upon an insurer who pays the premiums tax. By comparison, the later phrase in subsection (1) refers to "personal property of the insurer;" if the Legislature had meant to limit prohibited income taxes to those upon the insurer, it could have used the same language.

To avoid an open-ended prohibition of income taxes under subsection (1), the taxpayer invokes a general principle against double taxation to limit the alleged prohibition in subsection (1) to income taxes upon the premiums that have been subjected to the premiums tax. The taxpayer also reads subsection (2) as clarifying the scope of subsection (1) to extend subsection (1) to agents and other representatives. The foregoing argument is referred to below as the taxpayer's subsection (1) argument.

#### Analysis of Subsection (2) Argument

It is axiomatic that statutes granting tax exemptions must be strictly construed against the taxpayer and in favor of the State. Exemptions are never presumed; nor can a statute granting a tax exemption be extended by judicial construction to create an exemption not specifically authorized. *Owyhee Motorcycle Club, Inc. v. Ada County*, 123 Idaho 962, 964 (1993); *Housing Southwest, Inc. v. Washington County*, 128 Idaho 335 (1996).

The taxpayer's subsection (2) argument first interprets the word preempt to mean the same thing as prohibit. This is true only in part. The Tax Commission's response can be summarized by the heading of § 41-405. Subsection (1) substitutes the premiums tax for other taxes. Subsection (2) prohibits local taxes.

Preemption has an established meaning in constitutional law at both the federal and state levels. At the federal level, preemption is a doctrine that resolves the validity of state laws that conflict with federal laws.

If Congress enacts a law on a subject as to which power is expressly delegated to it by the federal Constitution, then preemption of the conflicting state or local laws flows from the substantive source of the Congressional action coupled with the Supremacy Clause of Article VI, which makes federal statutes “the supreme law of the land.” TRIBE, AMERICAN CONSTITUTIONAL LAW § 6-23 (1978) (section of treatise entitled, “The effect of federal legislation on state action: Preemption”).

If Congress is authorized to legislate on a subject but has not done so, then such “dormant” Congressional power may oust state authority over that subject. FRANKFURTER, THE COMMERCE CLAUSE UNDER MARSHALL, TANEY AND WAITE (1937) (discussing the concept but not using the “preemption” label).

Congress may also legislate on a given subject while leaving a vacuum as to a certain portion of the subject. In such cases, any state or local action as to the area of the vacuum may be held invalid, because the federal legislative scheme announces, or is best understood as implying, a Congressional purpose to “occupy the field.” Tribe, *loc. cit.*

At the state level, a similar dynamic governs the validity of local ordinances on a subject where the state legislature has acted. The conflict may be resolved by preempting the local law if the subject is a matter of statewide concern as to which a uniform rule is desirable; by upholding the local law if it does not prevent the practical operation of the state law; or by preempting the local law if the legislature has shown an intent to occupy the field. *E.g.*, *Jefferson v. State*, 527 P.2d 37 (Alaska 1974)(voter approval requirements); *In re Carol Lane*, 372 P.2d 897 (Cal. 1962) (criminal law); *Post v. City of Grand Junction*, 195 P.2d 958 (Colo.

1948) (local tax on state-regulated liquor dealer). *See generally* S. SATO & A. VAN ALSTYNE, STATE AND LOCAL GOVERNMENT LAW 155 *et seq.* (2d ed. 1977) (section of casebook headed, “Residual powers, preemption, and conflict”).

In Idaho, preemption statutes must be read strictly. *First American Title Co. of Idaho, Inc. v. Clark*, 99 Idaho 10, 13, 576 P.2d 581 (1978). In that case, the Idaho Supreme Court interpreted § 41-405 to prohibit a county ad valorem personal property tax on the local plant of an agent of a national title insurer. The national insurer paid the premiums tax; the local agent did not. The issue was whether personal property taxes were “similar taxes” to those expressly preempted in subsection (2).

The Idaho Supreme Court read subsections (1) and (2) together. Subsection (1) was enacted before subsection (2), and contained an exemption of insurers, but not their agents, from personal property taxes. Property taxes were the only taxes at the county level at the time subsection (2) was enacted. Refusing to find that the Legislature would enact subsection (2) with an intent not to preempt those taxes, which would leave subsection (2) with no practical impact, the Court held that subsection (2) preempted local property taxes on agents, including the personal property taxes at issue. Such a holding was consistent with the legislative intent to regulate the insurance industry at the state level.

The word preemption appears in some Idaho criminal statutes, in which the Legislature expressly states that statewide uniformity is its goal, and the state preempts regulation of the subject matter “to the exclusion of city and county governments.” *E.g.*, I.C. §§ 18-1521 & 18-4113.

We conclude that the term “preempt” in subsection (2) means that the subsection prohibits local taxes only.

The next question is whether the Tax Commission is within the class of “agenc[ies] in this state” that are preempted from imposing income taxes. The Idaho Supreme Court has held that under the *ejusdem generis* doctrine (Latin, meaning “of the same kind”), where general words of a statute follow an enumeration of persons or things, the general words will be construed as meaning persons or things of like or similar class or character to those specifically enumerated. *E.g.*, *Washington Water Power Co. v. Kootenai Environmental Alliance*, 99 Idaho 875, 591 P.2d 122 (1979). Here, the list reads, “county, city, municipality, district, political subdivision or agency in this state.” The first four units are all local governments, in roughly descending order of size. A political subdivision is also a unit that is a subset of the state. There are agencies below the state level, some of which are authorized to raise revenue. Examples include housing authorities (I.C. § 50-1905), county fair boards (§ 22-201), the Big Payette Lake Water Quality Council (§ 39-6603), regional airport authorities (§ 21-805), and regional public transportation authorities (§ 40-2105). Such local agencies are the intended targets of the word “agency” in subsection (2). The Tax Commission is not an “agency in this state” within the meaning of that subsection.

The taxpayer’s subsection (2) argument is without merit.

#### Analysis of Subsection (1) Argument

The taxpayer’s first contention in its subsection (1) argument is that payment of the premiums tax by an insurer is in lieu of all other taxes upon income, whether upon an insurer or upon someone else, because limiting language as to the taxpayer is absent from subsection (1). Recognizing that without a limiting principle, this interpretation literally could wipe out all income taxes in Idaho, the taxpayer then looks at subsection (2)’s treatment of insurers and their agents and representatives as a single class, and then backfills its subsection (1) argument with that concept.

If the intent of subsection (2) were to prohibit the imposition of state income tax on insurance agents, then the Legislature could have amended subsection (1) to add a reference to agents and representatives as protected classes. Instead, it enacted subsection (2), with its preemption language, to protect agents and representatives. Subsection (2) must have a different meaning from subsection (1), so as not to be superfluous. Therefore, insurance agents are protected only by subsection (2), while insurers are protected by both subsections.

The Idaho Supreme Court in the *First American Title* case, *supra*, interpreted subsection (2) to preempt local license fees, privilege and excise taxes and all “similar taxes,” which the Court interpreted to mean only “those [taxes] which tax a company’s right to engage in the title insurance business.” Since title insurers were required by statute to own tract indexes and abstract records in order to do business, any tax on those tools of the trade was “in reality, a tax upon the company’s privilege of engaging in the title insurance business.” 99 Idaho at 10, 13, 576 P.2d 581 (1978). Here, the income tax applies to all net profits of corporations in Idaho, whatever their occupation and without regard to any privilege. Income taxes are not within the “similar taxes” that are preempted by subsection (2). The taxpayer’s attempt to graft subsections (1) and (2) together is without merit.

Finally, the Tax Commission is aware of no prohibition of so-called double taxation of commissions on a gross basis and the insurance agency business on a net basis. The Idaho sales tax applies to retail sales on a gross basis, while merchants are subject to income tax on their net profits. Motor fuels are taxed on a volume basis, while fuel dealers pay income taxes. The present case, in which the insurer pays premiums tax and the agent pays income tax on its net profits, is no different.

The taxpayer’s subsection (1) argument is also without merit.

Penalty

The auditor's report omitted the calculation of the \$1,586 penalty that was imposed for YE 2000, and omitted an explanation of the penalty. In the absence of such explanation, the Tax Commission abates the penalty.

Conclusion

WHEREFORE, the Notice of Deficiency Determination dated January 8, 2001, is hereby MODIFIED and, as so modified, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following tax and interest (computed through 9/21/01) (interest runs at \$2.31 per day):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
06/30/98	\$ 0	\$0	\$ 0	\$ 0
06/30/99	0	0	0	0
06/30/00	10,572	0	794	<u>11,366</u>
			<u>TOTAL DUE</u>	<u>\$11,366</u>

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayer's right to appeal this decision is enclosed with this decision.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2001.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_ day of \_\_\_\_\_, 2001, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[REDACTED]

Receipt No. [Redacted]

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ADMINISTRATIVE ASSISTANT 1