

DEPARTMENT OF REVENUE

**ADMINISTRATION OF
INSURANCE PREMIUM TAXES**

Operational Audit



EXECUTIVE DIRECTOR OF THE DEPARTMENT OF REVENUE

Pursuant to Section 20.21(1), Florida Statutes, the head of the Department of Revenue is the Governor and Cabinet (Attorney General, Chief Financial Officer, and Commissioner of Agriculture). Pursuant to Section 20.05(1)(g), Florida Statutes, the Governor and Cabinet are responsible for appointing the Executive Director of the Department of Revenue. Lisa Vickers served as Executive Director during the period of our audit.

The audit team leader was Yueh-Lin DeGrove, CPA, and the audit was supervised by Richard Munson, CPA. Please address inquiries regarding this report to Kathryn Walker, CPA, Audit Manager, by e-mail at kathrynwalker@aud.state.fl.us or by telephone at (850) 487-9085.

This report and other reports prepared by the Auditor General can be obtained on our Web site at www.myflorida.com/audgen; by telephone at (850) 487-9175; or by mail at G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450.

DEPARTMENT OF REVENUE

Administration of Insurance Premium Taxes

SUMMARY

This operational audit of the Department of Revenue (Department) focused on the administration of the insurance premium tax and insurance premium excise taxes, including tax collection, return review and approval, delinquent tax collection, and tax distribution. Our audit disclosed the following:

Finding No. 1: The Department did not have procedures in place to compare information on authorized insurers to the Department's records showing insurers with insurance premium tax (IPT) accounts.

Finding No. 2: Insurer filing statuses were not timely updated and proper documentation was not required to evidence the reasons for changes in an insurer's filing status from "Active - required to file" to "Canceled - not required to file."

Finding No. 3: We found instances in which incorrect premium amounts and taxes due were reported on returns and accepted and approved by the Department.

Finding No. 4: The Department does not have the statutory authority to audit insurance premium excise taxes.

Finding No. 5: A Department-provided database, used by insurers to report the amounts of insurance premium excise taxes due to participating jurisdictions, was found to be incomplete in several instances.

BACKGROUND

Pursuant to State law,¹ every authorized insurer engaged as indemnitor, surety, or contractor in the business of entering into contracts of insurance or annuity in Florida shall annually remit a tax on insurance premiums, premiums for title insurance or assessments, and annuity premiums or considerations issued in the State of Florida. In addition to the tax on premiums, an excise tax may be levied by each municipality or special fire control district, and by each municipality or local law plan.²

Insurers are required to file an Insurance Premium Taxes and Fees Return form DR-908 (IPT return) annually on or before March 1. The IPT form makes provision for the reporting of insurance premium taxes, insurance premium excise taxes, State Fire Marshal regulatory assessments, and taxes due on the gross underwriting profit on wet marine and transportation insurance.³

To store the imaged returns and compute the taxes due, the Department utilizes the System for Unified Taxation by Systems, Applications, and Products in Data Processing Public Sector (SUNTAX/SAP). Department staff are to manually input into SUNTAX/SAP the amounts reported by insurers on the IPT returns and manually review and approve all returns by June 30.

For the fiscal year ended June 30, 2010, the Department collected approximately \$666 million in IPT, including taxes on property, casualty, life and health insurance premiums, excise taxes on property insurance, State Fire Marshal regulatory assessments, and taxes on the gross underwriting profit on wet marine and transportation insurance. The Department distributed State taxes of approximately \$460 million to the State General Revenue Fund; approximately \$36 million to the Department of Financial Services, Insurance Regulatory Trust Fund, for defraying costs of the

¹ Section 624.509, Florida Statutes.

² Sections 175.041 and 185.03, Florida Statutes.

³ Sections 624.515, and 624.510, Florida Statutes.

operation of the State Fire Marshall; approximately \$14 million to the Department of Community Affairs, Division of Emergency Management, Preparedness and Assistance Trust Fund; and approximately \$156 million to the Department of Management Services (DMS), Police and Firefighters' Premium Tax Trust Fund, for distribution to those jurisdictions which had authorized the assessment of an excise tax for the benefit of local police and firefighter pension funds.

FINDINGS AND RECOMMENDATIONS

As discussed in succeeding findings, our audit disclosed opportunities for the improvement of the Department's processes for identifying taxpayers and reviewing and approving returns.

Finding No. 1: Authorized Insurers

All insurers are required to register with the Office of Insurance Regulation (OIR) to obtain Certificates of Authority (COA) for conducting insurance business in the State of Florida.⁴ We obtained a list of authorized insurers from OIR and compared the OIR list to a Department list showing insurers with IPT accounts who were, thus, expected to file IPT returns on or before March 1. In comparing these two lists, we identified 17 insurers who had active COAs with OIR but did not have an IPT account established with the Department and had not filed a 2008 IPT return.

The Department did not have procedures in place to compare OIR information showing authorized insurers to the Department's records showing insurers with IPT accounts. Absent procedures to identify authorized insurers who do not have active IPT accounts, IPT due may not be collected. While information relative to the premiums collected by 11 of the 17 insurers was not readily available, the amounts not collected for the other 6 of these 17 insurers could exceed in total \$3 million annually. In response to our audit inquiry, Department management stated that the Department would establish a more direct communication process with OIR.

Recommendation: The Department should establish procedures requiring the periodic matching of OIR and Department information and the timely update of the IPT filer list.

Finding No. 2: Filing Status

In SUNTAX/SAP, the filing status for an IPT account is shown as either "Active - required to file" or "Canceled - not required to file." The Department was to update the filer's account status based upon telephone communications or written correspondence from the taxpayer. In addition, Department Field Office, Central Registration, Return Reconciliation, and Taxpayer Services personnel all had authorization to update the filing status of a taxpayer as necessary. Our analysis of the status of 41 insurers disclosed:

- The filing status for 8 of the 26 insurers whose COA had been surrendered according to OIR records had not been timely updated in SUNTAX/SAP. Specifically, the number of days between the insurers' COA status change dates (per OIR data) and Canceled - not required to file status dates (per DOR data) ranged from 514 to 609 days.
- For two of the 26 insurers which had surrendered their COAs, their filing statuses remained Active - required to file in SUNTAX/SAP.
- For 21 of the 33 insurers with a filing status of Canceled - not required to file in the Department's system, there was little or no documentation to explain the reason for the cancellations. In the response to our audit inquiry, Department management stated that there were notations in SUNTAX/SAP indicating why the filing

⁴ Section 624.401, Florida Statutes.

statuses were changed to Canceled; however, we reviewed the IPT accounts and determined that the notations did not provide sufficient explanations for the filing status changes. We also found no evidence that the changes in status had been subjected to supervisory review. Upon inquiry, the Department was able to determine the reasons for the canceled status, in some instances. In these instances, the taxpayer had paid under a different account number or was determined to be exempt from insurance premium taxes.

Absent the timely updating of insurer filing status, the Department is unable to efficiently verify that those insurers who should be filing an IPT return have filed a return. Additionally, without proper supporting documentation and supervisory review of the reasons for filing status changes, the filing status could be inappropriately changed and the taxes due may not be collected by the Department.

Recommendation: The Department should establish procedures for verifying insurers' COA status with OIR and, to prevent inappropriate collection efforts, specify an appropriate period within which to update the filing status. Further, to ensure only valid account status changes are made, the Department should develop policies and procedures for adequately documenting and reviewing filing status changes.

Finding No. 3: Manual Review of IPT Returns

At the beginning of each calendar year, the Department sends the IPT return form to insurers with a filing status of Active - required to file. The completed form and payment for any associated taxes are to be returned to the Department on or before March 1. Insurers are also required to attach to the IPT return excerpts from their annual statement submitted to the National Association of Insurance Commissioners (NAIC) and State insurance regulators.⁵ IPT returns are to be filed for calendar year periods and only by paper. Upon receipt of the completed IPT return, Department staff are to manually input the reported amounts into SUNTAX/SAP for recomputation. The tax return documents are then to be imaged by SUNTAX/SAP and reviewed by Department staff for accuracy and completeness, including in that process a comparison of IPT return amounts to the annual statement excerpt.

We reviewed 67 insurer's 2008 IPT return documents and the associated tax amounts recomputed by SUNTAX/SAP and noted the following instances that indicated a need to enhance Department review procedures:

- Documentation for 8 of the 67 returns did not include excerpts from the insurers' annual statements and there was nothing to demonstrate that the Department had contacted the insurers to request this information. In response to our audit inquiry, Department management stated that, if an annual statement excerpt is not received, the return is to be processed as filed.
- Documentation for 3 insurers did not include the required reconciliation⁶ to account for differences between the amounts reported on IPT return Schedule I (Computation of Tax) and the annual statement. One other insurer provided the reconciliation, but the reconciliation did not explain the difference shown. The taxes potentially underpaid by these 4 insurers exceeded in total \$200,000. In response to our audit inquiry, Department management stated that one instance was taxpayer error; in two instances, no explanation was provided concerning the difference between the amount reported on Schedule I of the return and the annual statement available; and one instance was referred to the Department's taxpayer audit section.
- IPT return Schedule II (Annuity Consideration Premiums) is to be used by the insurer to report gross receipts for annuity policies. Tax is not imposed on annuity receipts if the tax savings derived are credited to the

⁵ Instructions for preparing the form DR-908, *Florida Insurance Premium Taxes and Fees Return*, require insurers to attach a copy of the Florida Business Page from the annual statement to form DR-908 when it is filed. Annual statements contain, by state and tax year, the premiums billed for each of the different types of insurance written.

⁶ Schedule I requires a reconciliation of Florida premiums included in the annual statement to the total taxable premiums reported on the DR-908.

annuity holders.⁷ For one insurer who reported a credit of \$2.8 million, the Schedule II indicated that annuity premiums totaled \$509 million; while the insurer's annual statement indicated that premiums totaled \$796 million. The Department did not obtain an explanation for the difference.

- For 4 insurers, over \$200,000 of salary tax credits and corporate tax credits taken on IPT return Schedule III (Credits Against the Tax) were not supported by the required documentation.⁸ Specifically, in response to our audit requests, the Department was unable to provide documentation supporting salary tax credits taken for \$70,000 and \$74,000 and corporate tax credits taken for \$81,000 and \$7,000.
- For 7 insurers, we noted inconsistencies between the premiums reported on IPT return Schedule X (State Fire Marshal Regulatory Assessment Tax/Surcharge) and the insurers' annual statements. If the amounts on the annual statements were accepted as correct, the associated underpayment of taxes would have been approximately \$37,000.

The ineffective review of IPT returns could result in the over-payment or under-payment of taxes. We noted that improvements could be made in procedures to better ensure effective IPT tax return reviews were not in place. Such procedures might include the use of review checklists, second reviews for a sample of returns, and the use of NAIC information when annual statement information is not provided.

Recommendation: To ensure a thorough review, the Department should develop a checklist for each IPT return schedule and implement a second review for a sample of approved returns. In addition, the Department should consider obtaining access to the NAIC Web site (<https://i-site.naic.org/>) to obtain an insurer's annual statement if it is not provided by the insurer. We also recommend that, as appropriate, the Department pursue the collection of taxes from those insurers who underpaid.

Finding No. 4: Taxpayer Audits – Insurance Premium Excise Taxes

State law⁹ provides that insurers selling property insurance in Florida must pay an excise tax if such a tax is levied by the Florida municipality or special fire control district in which the property is located. State law¹⁰ also provides that insurers selling casualty insurance in Florida must pay an excise tax, if such a tax is levied by a Florida municipality or local law plan in which the property is located. Property and casualty insurance premiums taxes due are to be reported on IPT return Schedules XII and XIII, respectively, and the associated excise taxes are to be collected by the Department. Schedules XII and XIII are to show for each participating local entity the premiums collected for property located within the boundaries of the entity, as well as the excise taxes due. The DMS is responsible for distributing the excise taxes collected to the applicable local firefighters' pension trust funds and the municipal police officers' retirement trust funds.

The Department performs audits of tax returns to enforce the Florida tax laws uniformly, deter tax evasion, promote voluntary compliance and to educate taxpayers. The audit function also provides additional assurance that all tax revenues due are collected. We noted that while the Department has the authority¹¹ to audit the insurance premium taxes that are to be reported in IPT returns, that audit authority does not specifically extend to excise taxes assessed under Chapters 175 and 185, Florida Statutes, (reported on Schedules XII and XIII of the IPT returns), and as a

⁷ Section 624.509(8), Florida Statutes.

⁸ If an insurer is claiming the salary tax credit, the insurer must submit form UCT-6 for each quarter of credit claimed and UCS-71, if applicable. These forms show employer payroll information. Salary tax credits are based on salaries paid the insurers' employees based in Florida. Corporate consolidated returns are required to show how the credit is claimed by each subsidiary.

⁹ Section 175.101, Florida Statutes.

¹⁰ Section 185.08, Florida Statutes.

¹¹ Section 213.05, Florida Statutes.

consequence, the Department does not perform such audits. Further, Department rules state, in part, that the administration, auditing, collection, and enforcement of the insurance premium taxes and assessments are vested in the Department, with the exception of taxes collected under Chapters 175 and 185, Florida Statutes, where the Department's only functions are collection and maintenance of a database.¹² As a courtesy to DMS, Division of Retirement, the Department does request insurance companies to provide a written explanation when there is a significant change in the premiums reported for the local insurance premium tax.

Absent the authorization of audits of the insurance premium excise taxes, assurance of insurer compliance with laws and regulations is decreased and the applicable local firefighters' pension trust funds and the municipal police officers' retirement trust funds may not receive the excise taxes due.

Recommendation: To better ensure insurer compliance with laws and regulations, the Legislature should consider amending Sections 175.101 and 185.08, Florida Statutes, to authorize the Department to audit the excise taxes and to assess and collect assessed taxes based on the audit.

Finding No. 5: Electronic Database Updates

Pursuant to State law,¹³ the Department created a database that insurers, at their option, may use in assigning premiums and policies to the local jurisdictions which have assessed insurance premium excise taxes. To defray the costs of maintaining the database, the Department charges the DMS Police and Firefighters' Premium Tax Trust Fund. A charge of \$100,000 was made relative to the 2008 tax year.

Each participating local taxing jurisdiction is required to furnish to the Department all the information needed to create and update the Department's address database, including changes through annexations, incorporations, and reorganizations and any other changes in jurisdictional boundaries. The GeoTax System is used by the Department to process additions and deletions of addresses, to view the fire and police codes showing jurisdictional assignments, and for insurer downloading of the address database for use in assigning the premiums to the taxing jurisdictions. Insurers must register at <http://geotax.state.fl.us> to download the address and jurisdiction database files for the excise taxes. The single address look-up is to reflect the most current information from the updated database and is to include any new information submitted by local taxing jurisdictions.

We reviewed 40 changes submitted by local taxing jurisdictions, 20 addresses newly incorporated in the City of Tallahassee, and 20 annexation records provided by the Department of State, and identified seven addresses for which fire control district codes were not found in the Department's electronic database. In response to our audit inquiry, Department management stated that it appeared that fire control district codes were not being added to the database when a new address record was added.

Because of these system errors, insurance premium excise taxes may not be correctly assigned to the applicable jurisdiction should an insurer rely on the Department's database. In May 2011, the Department stated that the necessary system changes had been made to ensure all fire control district codes are appropriately added to the address database.

Recommendation: The Department should monitor the effectiveness of the system changes.

¹² Department Rule 12B-8.001(1), Florida Administrative Code.

¹³ Sections 175.015 and 185.085, Florida Statutes.

OBJECTIVES, SCOPE, AND METHODOLOGY

The Auditor General conducts operational audits of governmental entities to provide the Legislature, Florida's citizens, public entity management, and other stakeholders unbiased, timely, and relevant information for use in promoting government accountability and stewardship and improving government operations.

We conducted this operational audit from March 2010 to November 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This operational audit focused on the administration of the insurance premium tax and insurance premium excise tax (IPT). The overall objectives of the audit were:

- To evaluate the effectiveness of established internal controls in achieving management's control objectives in the categories of compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of State government; the relevance and reliability of records and reports; and the safeguarding of assets.
- To evaluate management's performance in achieving compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of State government; the relevance and reliability of records and reports; and the safeguarding of assets.
- To identify statutory and fiscal changes that may be recommended to the Legislature pursuant to Section 11.45(7)(h), Florida Statutes.

In conducting our audit, we:

- Obtained an understanding of Department procedures for administering the IPT.
- Interviewed Department staff in various business processes to gain an understanding of IPT collection, review and reconciliation, approval, and distribution processes.
- Obtained an understanding of the Department's creation and processes for the maintenance of the electronic address database.
- Focused records testing on IPT returns for the 2008 calendar year, which were due no later than March 1, 2009, and for which processing and follow-up was to be completed by February 2010.
- Determined whether the Department's taxpayers records were complete, compared the licensed insurer data provided by the Office of Insurance Regulation to the Department's records of insurers who were expected to file IPT returns.
- Identified taxpayers who had not filed returns or paid the estimated taxes due and filing fees but had active certificates of authority to conduct insurance business in Florida.
- Examined the license data and filing status for 64 insurers to determine the accuracy of the filing status in the Department's records.
- Researched the types of premiums listed in an insurer's annual statement to determine the types of taxes that were applicable to each type of premium.
- Computed taxes due that were not reported because the insurers were either not registered in SUNTAX/SAP or IPT accounts had not been created.
- Examined 67 insurers' reported premiums and taxes due and SUNTAX/SAP's computed amount to determine whether the reported amounts were complete and accurate.

- For 54 property and casualty insurers' IPT returns, examined Schedules XII and XIII and the associated excise taxes levied under Chapters 175 and 185, Florida Statutes, to determine the taxable amount to be distributed to the local taxing jurisdictions.
- Examined the returns for 54 insurers to determine whether the insurer had used the Department's electronic address database, via <http://geotax.state.fl.us>, to assign IPT to the correct taxing jurisdictions.
- Examined 40 address changes submitted by the local taxing jurisdictions, 20 new addresses incorporated in the City of Tallahassee, and 20 annexation records from the Department of State to determine whether the Department's master address list was complete and had been timely updated.
- For 54 insurers, compared IPT collected for the 2007 and 2008 tax years and examined the explanations provided by the insurers to evaluate the sufficiency of the explanations for significant variances when identified.
- Examined 23 delinquent tax cases to determine if the collection process had been timely initiated.
- Performed various other audit procedures, including analytical procedures, as necessary, to accomplish the objectives of the audit.
- Prepared and submitted for management response the findings and recommendations that are included in this report and which describe those matters requiring corrective actions.

AUTHORITY

Section 11.45, Florida Statutes, requires that the Auditor General conduct an operational audit of each State agency on a biennial basis. Pursuant to the provisions of Section 11.45, Florida Statutes, I have directed that this report be prepared to present the results of our operational audit.



David W. Martin, CPA
Auditor General

MANAGEMENT'S RESPONSE

In a response letter dated June 23, 2011, the Executive Director of the Department concurred with our audit findings and recommendations. The Executive Director's response is included as EXHIBIT A.

**EXHIBIT A
MANAGEMENT'S RESPONSE**



Executive Director
Lisa Vickers

Child Support Enforcement
Ann Coffin
Director

General Tax Administration
Jim Evers
Director

Property Tax Oversight
James McAdams
Director

Information Services
Tony Powell
Director

June 23, 2011

Mr. David W. Martin, CPA
Auditor General
Office of the Auditor General
G74 Claude Pepper Building
111 West Madison Street
Tallahassee, Florida 32399-1450

Dear Mr. Martin:

As required by section 11.45(4)(d), Florida Statutes, enclosed is the Department's response to the preliminary and tentative findings and recommendations of your operational audit of the Department of Revenue, Administration of Insurance Premium Taxes.

We appreciate the professionalism displayed by your audit staff. If further information is needed, please contact Teresa Wood, Director of Auditing, at 717-7598.

Sincerely,

Lisa Vickers

LV/tw

Enclosure

cc: Sharon Doredant, Inspector General
Teresa Wood, Director of Auditing

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EXHIBIT A
MANAGEMENT'S RESPONSE (CONTINUED)

Department of Revenue
Auditor General Operational Audit – Administration of Insurance Premium Taxes
Preliminary and Tentative Response

Finding 1: The Department did not have procedures in place to compare information on authorized insurers to the Department's records showing insurers with insurance premium tax (IPT) accounts.

Recommendation: The Department should establish procedures requiring the periodic matching of OIR and Department information and the timely update of the IPT filer list.

Response: The Department has compared information on authorized insurers from the Office of Insurance Regulation (OIR) to the Department's records. The Department periodically reviewed information on the OIR Internet site to identify and obligate new companies for insurance premium tax. Information on premiums by company has been received from OIR annually and compared with the Department's records. Generally, an insurer estimated to owe more than \$250 in insurance premium tax is assigned for audit.

The Department, beginning in 2010, established procedures for a more direct and timely receipt of information from OIR. The Department now receives information on changes in the status of insurance companies on a quarterly basis and updates records accordingly. In addition, beginning in 2011 the annual information received from OIR on premiums by company for the prior calendar year is now received in early May instead of July.

Finding 2: Insurer filing statuses were not timely updated and proper documentation was not required to evidence the reasons for changes in an insurer's filing status from "Active - required to file" to "Canceled - not required to file."

Recommendation: The Department should establish procedures for verifying insurers' COA statuses with OIR and, to prevent inappropriate collection efforts, specify an appropriate period within which to update the filing status. Further, to ensure only valid account status changes are made, the Department should develop policies and procedures for adequately documenting and reviewing filing status changes.

Response: The Department has established procedures and all filing status changes are documented and/or verified at the time the change is made. The Department is in the process of improving the ability to subsequently access all such documentation more easily. Please also see the response to Finding 1 regarding verification with, and access to, OIR records.

EXHIBIT A
MANAGEMENT'S RESPONSE (CONTINUED)

Department of Revenue
Preliminary & Tentative Findings – Response
AG Operational Audit of Insurance Premium Taxes

Finding 3: We found instances in which incorrect premium amounts and taxes due were reported on returns and accepted and approved by the Department.

Recommendation: To ensure a thorough review, the Department should develop a checklist for each IPT return schedule and implement a second review for a sample of approved returns. In addition, the Department should consider obtaining access to the NAIC Web site (<https://i-site.naic.org/>) to obtain an insurer's annual statement if it is not provided by the insurer. We also recommend that, as appropriate, the Department pursue the collection of taxes from those insurers who underpaid.

Response: The Department has made improvements in its review of the IPT returns. Beginning in 2011 we now receive information on premiums by company from OIR in early May, which is used to verify taxable premiums in those instances where the insurance company does not provide copies of the excerpts from their annual statements. The Department has revised the Instructions For Preparing Form DR-908 Florida Insurance Premium Taxes and Fees Return (DR-908 R. 01/11), Schedule X to better explain premiums that are subject to the State Fire Marshall Regulatory Assessment. The Department is in the process of improving the ability to subsequently access all documentation initially used in the review of a tax return more easily. The Department will continue to pursue the collection of taxes from insurers who underpay. Please also see the response to Finding 1.

Finding 4: The Department does not have the statutory authority to audit insurance premium excise taxes.

Recommendation: To better ensure insurer compliance with laws and regulations, the Legislature should consider amending sections 175.101 and 185.08, Florida Statutes, to authorize the Department to audit the excise taxes and to assess and collect assessed taxes based on the audit.

Response: This is a policy decision of the Florida Legislature.

Finding 5: A department-provided database, used by insurers to report the amounts of insurance premium excise taxes due to participating jurisdictions, was found to be incomplete in several instances.

Recommendation: The Department should monitor the effectiveness of the system changes.

Response: The Department is monitoring the effectiveness of the system changes but has recommended that this issue be resolved by legislative action. Many jurisdictions do not update their respective databases.