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LBJ State Office  
Building

The Honorable Daniel C. Morales  
Attorney General of Texas  
Price Daniel, Sr. Building  
209 West 14th Street, 8th Floor  
Austin, Texas 78701-1614

Dear Dan:

This office respectfully requests your opinion concerning whether the Texas Workers Compensation Facility ["the Facility"] is subject to the maintenance tax surcharge under Texas Insurance Code Article 5.76-5 and the rules promulgated thereunder by the Texas Department of Insurance ["TDI"]. If you determine that the Facility is subject to the maintenance tax surcharge, I have additional questions regarding the extent to which the Facility may be due a refund. The answer depends to a large extent on whether the governing rule promulgated by TDI, found at 28 T. A. C. §1.411, is found to be valid.

### Background

The Facility is a nonprofit unincorporated association of insurers created pursuant to Texas Insurance Code Article 5.76-2. The Facility was created to write workers' compensation insurance in Texas for employers unable to obtain coverage through private insurance companies.

The Facility replaced the Texas Workers Compensation Assigned Risk Pool as the insurer of last resort effective January 1, 1991. It, in turn, was replaced by the Texas Workers Compensation Insurance Fund ["the Fund"] on January 1, 1994. To effectuate the replacement, the Legislature abolished the governing committee of the Facility as it existed on December 31, 1991, effective January 1, 1992, prohibited workers compensation insurance from being written through the Facility on or after January 1, 1994, and required the Facility to contract with the Fund to assume all claim liabilities by January 1, 1999. The Fund and the Facility will co-exist until January 1, 1999, while the Facility winds up its business. Act of Dec. 11, 1989, 71st Leg., 1d C.S., ch. 1, §17.09(1), 1989 Tex. Gen. Laws 1, 117. Act of Aug 25, 1991, 72nd Leg., 1d C.S., ch. 12, §18.24(b), 1991 Tex. Gen. Laws 252, 362, as amended by Act of May 26, 1993, 73d Leg., R.S., ch. 885, §8(b), 1993 Tex. Gen. Laws 3512, 3515.

The maintenance tax surcharge was enacted by the Texas Legislature in 1991, and the revenues derived from it were pledged as security to guarantee payment of \$300 million

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in revenue bonds issued by the Texas Public Finance Authority ["TPFA"]. The bond issue financed the establishment of the Fund.

The maintenance tax surcharge is set annually by the TDI pursuant to rule, 28 T. A. C. §1.411, and it is among the taxes collected by the Comptroller of Public Accounts under Article 1.04D of the Insurance Code.

The Facility provided workers compensation coverage for Texas employers from 1991 to 1994 through servicing companies. The servicing companies issued the policies to rejected risks as the agent of the Facility, collected all premiums due, and paid all appropriate taxes on the premiums (including the maintenance tax surcharge). The Facility reimbursed the servicing companies for all payments made in connection with the policies issued on the Facility's behalf. The Facility did not make direct payment of the maintenance tax surcharge to the State, but the Facility has been held to be the insurer with respect to the policies issued. Maintenance Group, Inc. v. Hartford Group, Inc., 895 S.W.2d 816 (Texarkana Civ. App., 1995, writ ref.).

The maintenance tax surcharge in issue was paid voluntarily and without dispute by the servicing companies, which were reimbursed by the Facility as required by the TDI's rule, 28 T.A.C. §1.411(d).

The Insurance Code, Article 5.76-5, sec. 10(d), authorizes each "insurance company" paying the maintenance tax surcharge to pass through the amount of the tax to each of its policyholders. Implementing this statute, the TDI rule (§1.411, subsequently adopted by the Comptroller in identical language as Comptroller's Rule 3.804) authorizes each servicing company to recoup the maintenance taxes paid by passing the charge through to their policyholders, following the procedure set out in the rule, and requires the servicing companies to remit the entire amount attributable to the charge, as collected, to the Facility. Copies of both the TDI rule and the identical rule adopted by the Comptroller after responsibility for collection of this tax was transferred to the Comptroller in 1993 are attached hereto as Appendices 1 and 2, respectively, for convenient reference.

Of the total amount of \$40,289,243 paid, the Facility states it has recouped from the servicing companies only \$16,665,658. It states that it has been unable to recoup the remaining \$23,623,585 for several reasons:

- a. In 1994, \$4,398,183 in surcharges was paid but unrecouped because the Facility was no longer writing insurance and no policies were written from which to recoup this money. The recoupment period was June 1, 1994 through June 1, 1995, and the Facility ceased issuing policies in December 1993.

- b. In 1993, \$1,182,843 was unrecouped because the Facility was no longer writing insurance policies from which to recoup this money. The recoupment period was June 1, 1993, through June 1, 1994. Therefore, the Facility could not recoup the surcharges from January through May 1994, because there were no policies from which to recoup this money. Additionally, \$7,361,622 was unrecouped because the Facility felt that if it sought full recoupment, the group of employers it was created to insure would not have been able to afford their policies.
- c. In 1992, \$10,680,937 was unrecouped because the Facility apparently felt that if it sought full recoupment, the group of employers it was created to insure would not have been able to afford their policies.

In 1992 and 1993 the Facility filed letters with TDI stating the method by which it proposed to recoup the surcharge (copies enclosed herewith as Appendix 3).

Although the Facility originally requested that the Comptroller refund the full amount of all surcharges paid with respect to its policies of insurance, it has amended its request to state that it now only requests the refund of the amount it did not recoup, \$23,623,585 (see First Amended Reply to Position Letter, 4/22/96, enclosed herewith as Appendix 4).

### **Facility's Position**

The Facility contends that it is not an "insurance company" and, therefore, the statute imposing the surcharge does not impose the surcharge on the Facility. It argues that the TDI rule, 28 TAC §1.411, which purports to impose the maintenance tax surcharge on the Facility, is invalid. It contends the tax was paid in error and should be refunded. To eliminate any question concerning its standing to claim the refund, since the tax was actually remitted by the servicing companies, the Facility has obtained assignments of the right to refund from the servicing companies.

The Facility has also filed an alternative claim for refund, stating that, if it is held to be an "insurance company," the statute nonetheless provides that insurance companies writing workers' compensation insurance in Texas who cease writing business in the state will be relieved of the requirement to pay this tax (with respect to premiums on policies written earlier) "in any year in which the surcharge assessed against insurance companies continuing to write workers' compensation insurance in this state is sufficient to service the bond obligation." Art. 5.76-5, §10. Since it ceased writing business (through the servicing companies) in December 1993, the Facility contends its right to refund with respect to 1994 is indisputable.

### Comptroller's Position

This agency has, thus far, denied the claim for refund (see Position Letter dated November 1, 1995, enclosed herewith as Appendix 5). The Facility has requested from this agency an administrative hearing. Since the Facility's claims hinge upon interpretation of the Insurance Code and TDI rules, and given the potential impact of this matter upon TDI, the Facility, the Fund, and TPFA, as well as the servicing companies and other insurance companies writing workers compensation insurance in this state, I believe it is necessary and appropriate that formal guidance be sought and obtained from your office. We intend to hold further administrative proceedings relating to this matter in abeyance pending issuance of your opinion.

The holding in Maintenance Group, Inc. v. Hartford Group, Inc., 895 S.W.2d 816 (Texarkana Civ. App., 1995, writ ref.) that the Facility is the insurer suggests that any question of whether the Facility stands in the position of the "insurance company" for purposes of this tax may be settled. This case also supports the conclusion that the TDI rule requiring the Facility to pay the tax (through the servicing companies) was valid, and the Facility was liable for the tax until at least the end of December, 1993, when it ceased writing business in the state.

The \$300 million bond issue serviced by the maintenance tax surcharge was issued and sold on the basis of a fiscal assumption that a surcharge paid by all Texas workers compensation insurers would pay the bonds. Article 5.76-5, §5 authorized TPFA to issue the bonds, and in issuing the bonds TPFA made the following assertions:

1. In its application for the bond review board approval, TPFA states that "[t]he maintenance tax surcharge is required by H. B. 62 to be assessed and collected by [TDI] for the Fund against all workers compensation insurers in the State of Texas on the basis of premiums written." [Emphasis added.]
2. Appendix C of the Bond itself contains projected gross workers' compensation insurance premiums to be written in Texas from 1991 through 2006. These premiums are to be the sources from which the maintenance tax surcharge are expected to be collected. Included in the projections are the Facility's premiums.

The bonds were approved by the Bond Review Board and the Attorney General of the State of Texas. Bonds that have been approved by the Attorney General and registered with the State Comptroller are incontestable as to their validity. Yoakum County Water Control and Improvement District v. First State Bank, 449 S. W.2d 775 (Tex. 1969). If premiums paid on the Facility's workers' compensation insurance are exempted from the maintenance tax surcharge, the fiscal assumptions on which the bonds were issued will be undermined.

If the terms of Art. 5.76-5, §10 have been met, the law relieved the Facility of liability for the tax effective January 1, 1994, since it wrote no business after that date. The question is whether "the surcharge assessed against companies continuing to write workers compensation insurance in this state was sufficient to service the bond obligation" under terms of that statute.

To our knowledge no licensed workers compensation insurer in Texas that has discontinued writing workers compensation policies in this state, other than the Facility, has made a claim of exemption from paying the surcharge while also claiming that the companies paying the surcharge had provided sufficient funds to service the bond obligation, so there is no precedent to aid in interpretation of this statute. There is, in fact, serious question whether the funds provided by the surcharge were sufficient to service the bond obligation for 1994, if the \$4,398,183 sought by the Facility with respect to that year is somehow refunded.

The fact that no other insurers have sought the exemption claimed by the Facility, based on their withdrawal from writing workers compensation policies in the state, may be due to the fact that the applicable statute and rules, cited above, appear to allow the insurer to fully recoup all such tax payments by passing them on to their policyholders. When the statute does not require the insurers to bear the burden of the tax themselves, they obviously have little incentive to claim exemption or refund.

It is one thing for an insurer to prospectively claim an exemption from the surcharge on grounds that it is no longer writing such business, and quite another to claim a refund for past payments on such grounds. In the first instance, it would seem the insurer's claim of exemption could be held in abeyance until such time as it is determined whether sufficient funds are available to service the bonds. In this instance, where the tax was paid and a claim for refund has been filed, the surcharge collected with respect to 1994 has already been applied, and it appears no funds are available to pay a refund. Furthermore, if the amount paid on behalf of the Facility was subtracted from the total amount of the surcharge collected in 1994, it appears the funds available would not have been sufficient to service the bonds. [We will supply confirmation of this statement directly from TDI, which administers the funds derived from the surcharge and is responsible for servicing the bonds through depositions of TDI and Comptroller personnel taken in connection with the Comptroller's administrative proceeding. Deposition excerpts will be furnished to your office as soon as they are available.] A letter to that effect from TDI's Chief Accountant, Mr. Joe Meyer, dated May 20, 1996, is attached as Appendix 6.

If a refund is to be paid to the Facility out of maintenance tax surcharge funds collected in the future, that would serve to increase the amount needed to meet the funding obligations of the surcharge, i.e., the rate of tax set for this purpose by TDI. As pointed out above, Article 5.76-5, §10(d) provides for the surcharge to be passed through to

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policyholders. Thus, all workers compensation insurers and all policyholders have an interest in this question because there is no way to pay a refund to the Facility without substantially increasing the maintenance tax surcharge rates charged other workers' compensation insurers, and those companies would in most instances pass the tax burden on to their policyholders.

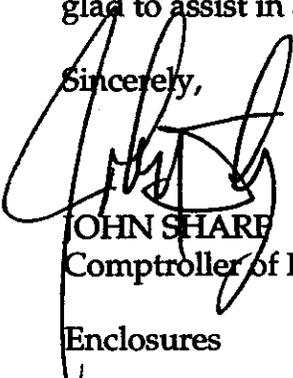
Requiring a refund to be paid long after the surcharge has been collected, remitted to TDI and applied to service the bonds would be a cumbersome process which would result in a shifting of the tax burden in a manner never intended by the Legislature. Instead of being passed through on a timely basis to policyholders in the year immediately following the calculation and payment of the surcharge, it would have to be recouped from companies selling workers' compensation policies several years after the fact and would be passed on to the policyholders of those companies.

This office has not received any statements of position from the TDI, the TPFA, other insurers, or policyholders. We have received several written inquiries from servicing companies inquiring whether they should continue to remit the maintenance tax surcharge with respect to workers compensation premiums which they are continuing to collect on policies written on behalf of the Facility, and we have consistently advised the servicing companies that that they should continue remitting the tax.

It is the view of this agency that the Facility and its servicing companies, like all other insurers writing workers compensation insurance, have a right to full recoupment of the maintenance tax surcharge by passing it through to their policyholders. Since it was the servicing companies that collected and remitted the tax in question, which the Facility now seeks to have refunded, it may be appropriate for the servicing companies to recoup the tax paid by passing it through to their policyholders in the manner provided in the statute and rules. If they have chosen not to recoup the tax from their policyholders, it is our view that such decision does not give rise to a right to refund.

We will make the entire file pertaining to this matter available to your office and will be glad to assist in any way possible in the resolution of this matter.

Sincerely,



JOHN SHARE  
Comptroller of Public Accounts

Enclosures

cc: Peter Potemkin, Executive Director  
Texas Workers' Compensation Insurance Facility