



TAXPAYER INFORMATION RULING LR15-007

Douglas A. Ducey
Governor

David Raber
Director

July 14, 2015

The Department issues this taxpayer information ruling in response to your letter of March 6, 2015 requesting a ruling on behalf of two related unidentified taxpayers. Specifically, you request the Department rule on the applicability of Arizona's corporate income tax on two related unidentified taxpayers, Arizona Health Care Cost Containment System "AHCCCS" contractors that pay a premium tax under A.R.S. § 36-2905.

Statement of Facts

Arizona has a Medicaid insurance program for qualifying Arizona consumers called Arizona Health Care Cost Containment System "AHCCCS". AHCCCS enters contracts with health maintenance organizations and other companies (called "AHCCCS contractors") to provide health insurance plans for qualifying Arizona consumers. The contracts between AHCCCS and the contractors are prepaid capitated contracts that require the contractors to assume the risk of providing health insurance coverage for a flat fee.

XYZ, Inc. ("XYZ") is a health care company incorporated and domiciled outside of the state of Arizona. ABC, Inc. ("ABC") is a subsidiary of XYZ that is incorporated and domiciled in Arizona. ABC has a contract with the AHCCCS to provide health insurance benefits. The majority of ABC's revenues are derived from its contract with the AHCCCS. ABC also earns revenue by providing health care benefits through the Arizona Department of Economic Security Division for Developmental Disabilities and the Centers for Medicare and Medicaid Services.

DEF, Inc. ("DEF") is also a subsidiary of XYZ. DEF is incorporated and domiciled in Arizona. DEF has a contract with the AHCCCS to provide health insurance benefits to qualifying Arizona consumers. DEF's revenues are solely derived from this contract. DEF subcontracts with medical providers within Arizona to provide health care.

Both ABC and DEF are subject to Arizona premium tax under A.R.S. § 36-2905 because of their status as AHCCCS contractors. ABC and DEF have filed Arizona premium tax returns, and paid substantial amounts of tax, accordingly.

Question Presented By Taxpayer

Are ABC and DEF, AHCCCS contractor entities which are subject to and pay Arizona premium tax under A.R.S. § 36-2905, "insurance companies" exempt from paying Arizona corporate income tax under A.R.S. § 43-1201(A)(14)?

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Relevant Arizona Statutory Law

A.R.S. § 43-1111 provides there shall be a tax levied, collected and paid for each taxable year upon the entire Arizona taxable income of every corporation, unless exempt under section 43-1126 or 43-1201.

Organizations exempt from Arizona corporation income tax under A.R.S. § 43-1201(A)(14) include insurance companies paying to the state tax upon premium income derived from sources within this state.

Under A.R.S. § 36-2901(3) "Contractor" means a person or entity that has a prepaid capitated contract with the administration pursuant to section 36-2904 to provide health care to members under this article either directly or through subcontracts with providers.

Under A.R.S. § 36-2901(13) "Prepaid capitated" means a mode of payment by which a health care contractor directly delivers health care services for the duration of a contract to a maximum specified number of members based on a fixed rate per member notwithstanding:

- (a) The actual number of members who receive care from the contractor.
- (b) The amount of health care services provided to any member.

A.R.S. § 36-2905. Removal of medicaid special exemption for payments to contractors; civil penalty

A. Notwithstanding any other law, beginning on October 1, 2003, each contractor shall pay to the director of the department of insurance a tax equal to two per cent of the total capitation, including reinsurance, and any other reimbursement paid to the contractor by the administration for persons eligible pursuant to section 36-2901, paragraph 6, subdivisions (a) and (g) and article 4 of this chapter. The tax shall be paid in four payments pursuant to subsection C of this section and deposited in the state general fund pursuant to sections 35-146 and 35-147.

B. The contractor shall not deduct any disallowance or penalty imposed by the administration pursuant to this chapter from the financial information submitted to the director of the department of insurance.

C. Each contractor shall file the estimated tax and documentation with the director of the department of insurance on a form prescribed by the director of the department of insurance to pay the estimated tax. A contractor shall make estimated tax payments to the director of the department of insurance for deposit in the state general fund pursuant to sections 35-146 and 35-147. The tax payments are due on or before September 15, December 15, March 15 and June 15 of each year. The amount of the payments shall be an estimate of the tax due for the quarter that ends in the month that payment is due.

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D. On or before April 1, 2004 and annually on or before April 1 thereafter, the director of the department of insurance shall use data provided by the administration to reconcile the amount paid by each contractor pursuant to this section with the actual amount of title XIX and title XXI reimbursement made by the administration to the contractor in the preceding calendar year. If there is a discrepancy in the two amounts, the director of the department of insurance shall notify the contractor of the difference, provide a notice of right of appeal and bill the contractor for the unpaid amount of the premium tax or, if there is an overpayment, the director of the department of insurance shall either refund the amount of the overpayment to the contractor or issue a credit for the amount of the overpayment that the contractor can apply against future tax obligations prescribed by this section.

E. A contractor who fails to file an estimated payment or pay an unpaid premium tax as prescribed by this section is subject to a civil penalty equal to the greater of twenty-five dollars or five per cent of the amount due and is subject to interest on the amount due at the rate of one per cent per month from the date the amount was due.

Taxpayer Position

ABC and DEF are exempt from paying Arizona corporate income tax under A.R.S. § 43-1201(A)(14) as: (1) ABC and DEF are paying premium tax to Arizona; and, (2) ABC and DEF are "insurance companies" for purposes of this exemption because they provide health insurance to Arizona consumers who qualify for AHCCCS services.

Discussion

Pursuant to A.R.S. § 20-224, insurance companies must remit a premium tax of 2.0% on net premiums received. A.R.S. § 36-2905 requires all AHCCCS contractors to pay a similar tax of "two per cent of the total capitation, including reinsurance, and any other reimbursement paid to the contractors." Both A.R.S. § 36-2905(D)&(E) specifically refer to the tax contractors must remit under A.R.S. § 36-2905(A) as a premium tax. As AHCCCS contractors, ABC and DEF both remit premium tax pursuant to A.R.S. § 36-2905.

The Arizona corporation income tax is imposed on domestic corporations and foreign corporations having a business situs in the state. Pursuant to A.R.S. § 20-226, the premium tax that insurers pay under A.R.S. § 20-224 operates as payment in full in lieu of most other Arizona state and local taxes, including Arizona's corporation income tax. A.R.S. § 20-226 is silent regarding premium tax payments an AHCCCS contractor makes under A.R.S. § 36-2905. However, the exemption from tax on insurance companies authorized under A.R.S. § 43-1201(A)(14) is not by its terms limited to insurance companies paying premium tax under A.R.S. § 20-224.

Arizona law does not specifically define insurance company. However, Arizona law does define "insurer" as "every person engaged in the business of making contracts of insurance."

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A.R.S. § 20-104. Insurance is “a contract by which one undertakes to indemnify another or to pay a specified amount upon determinable contingencies.” A.R.S. § 20-103. Person “includes an individual, company, insurer, association, organization, society, reciprocal or inter-insurance exchange, partnership, syndicate, business trust, corporation and entity.” A.R.S. § 20-105.

Conclusion and Ruling

ABC and DEF are engaged in the business of administering and providing health insurance plans to Arizona consumers who qualify for AHCCCS services. AHCCCS compensates ABC and DEF through a prepaid capitated fee. As entities that have a prepaid capitated contracts to provide health care to members, ABC and DEF are considered contractors for purposes of A.R.S. § 36-2901(3). As required under A.R.S. § 36-2905, contractors ABC and DEF must both pay a two percent tax based on the total capitation, including reinsurance, and any other reimbursement paid to the contractors. Under A.R.S. § 36-2901(13) “prepaid capitated” means a mode of payment by which a health care contractor directly delivers health care services for the duration of a contract to a maximum specified number of members based on a fixed rate per member notwithstanding the actual number of members who receive care from the contractor or the amount of health care services provided to any member. The prepaid capitation fee ABC and DEF receive is not based on actual use during the life of the contract. ABC and DEF assume the risk that the capitated fee will cover services provided under the health insurance coverage they provide to AHCCCS qualifying consumers and indemnify the consumers for the health care they receive. This arrangement suggests ABC and DEF are “persons” providing “insurance” and therefore are operating as “insurers”. “Insurers” is a defined term that can reasonably substituted with the phrase “insurance companies” found in Title 43.

The two percent tax ABC and DEF remit to the Department of Insurance based on their prepaid capitated fee is identified as a premium tax under A.R.S. § 36-2905(D)&(E). Under A.R.S. § 43-1201(A)(14) insurance companies that pay premium tax on income from Arizona sources are exempt from Arizona’s corporation income tax. A.R.S. § 43-1201(A)(14) does not require the premium tax paid by an insurance company to be assessed under Title 20, only that a premium tax is paid. In previous rulings, the Department has relied on Arizona Attorney General’s opinions, relevant case law and the “in lieu” statutory language found in A.R.S. § 20-226 in determining whether Arizona’s corporation income tax applies to insurers. However, in this matter ABC and DEF are actually paying a premium tax so no such analysis is necessary. ABC and DEF are the functional equivalent of insurance companies and remit a two percent premium tax to the Department of Insurance. As such, for purposes of Title 43 both ABC and DEF are insurance companies paying premium tax on income derived from Arizona sources and therefore exempt from Arizona’s corporation income tax.

This response is a taxpayer information ruling (TIR) and the determination herein is based solely on the facts provided in your request. The determinations are subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the Department's making of an accurate determination, this taxpayer information ruling shall be null and void. Further, the

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determination is subject to future change depending on changes in statutes, administrative rules, case law, or notification of a different Department position.

If the Department is provided with required taxpayer identifying information and taxpayer representative authorization before the proposed publication date (for a published TIR) or date specified by the Department (for an unpublished TIR), the TIR will be binding on the Department with respect to the taxpayer that requested the ruling. In addition, the ruling will apply only to transactions that occur or tax liabilities that accrue from and after the date the taxpayer receives the ruling. The ruling may not be relied upon, cited, or introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the taxpayer information ruling. If the required information is not provided by the specified date, the taxpayer information ruling is non-binding for the purpose of abating interest, penalty or tax.

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