

Business License Confusion – Brokers and Agents

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MASC Municipal Association
of South Carolina

Insurance Tax Program (ITP)

- The Insurance Tax Program centralizes the licensing procedures for insurance companies and standardizes the collection rates and dates.
- Admitted insurance companies
 - Property and Casualty – 2% tax
 - Life, Accident, Health – 0.75% tax
 - Title – 2% tax

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Insurance Agents - Page 34, Business License Handbook

- **Covered under ITP**
 - W-2 Employees
 - Are they employed by the insurance company?
- **Not covered under ITP**
 - Independent Agents
 - 1099
 - Are they their own employer?

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Insurance Agents - Page 34, Business License Handbook

- How do I license independent agents not covered under the Insurance Tax Collection Program?
 - Class 7
 - For independent insurance agents, gross income is gross commission

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Insurance v. Brokers – What's the difference?

- Both deal with insurance
- Insurance Tax Collection
 - Admitted insurance companies
 - Standard policies
- Brokers Tax Collection Program
 - Non-admitted insurance companies
 - High-risk policies

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Brokers Tax Program (BTP)

- After the passage of the federal Dodd-Frank Act and a provision within the Act known as the Non-Admitted and Reinsurance Reform Act of 2010, conformed state insurance law to federal law.
- The Act establishes a blended broker's premium tax rate of 6%, comprising a 4% state broker's premium tax and a 2% municipal broker's premium tax.
- The South Carolina Department of Insurance is required to collect the broker's premium tax and distribute to the Municipal Association of South Carolina the municipal portion of the tax. As the municipal agent, the Association distributes the funds to the municipalities.

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Insurance Brokers - Page 35, Business License Handbook

- Sell high-risk non-admitted policies.
- You will never license an insurance broker.
- Insurance agents may call themselves brokers.
- Questions to ask:
 - Do you sell non-admitted policies?
 - Do you pay the 6% Brokers Premium Tax to the SC Department of Insurance?

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Real Estate Broker-In-Charge - Page 41, Business License Handbook

- You will never license individual realtors, only the broker-in-charge.
 - The governing body of a county or municipality may not impose a license, occupation, or professional tax or fee upon real estate licensees, except upon the broker-in-charge at the place where the real estate licensee shall maintain a principal or branch office.
- How do you know if you can license them?
 - Brokered transactions of real property in counties or municipalities, other than those in which the broker-in-charge maintains a principal or branch office, create a nexus for imposition of a license, occupation, or professional tax or fee only with respect to gross receipts derived from transactions of property located in that county or municipality.

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Real Estate Broker-In-Charge - Page 41, Business License Handbook

- How do I license the broker-in-charge?
 - Commissions received by real estate brokers constitute gross income for license purposes. If commissions are divided with other brokers or salesmen, as frequently occurs, only the amount retained by a broker is considered income to him. *SC Code Sec. 6-1-400(E)(1)(b).*

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Questions?

- Insurance Agents – covered under ITP
- Insurance Agents – not covered under ITP
- Insurance Brokers – all covered under BTP
- Brokers-In-Charge – real estate

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Resources

Municipal Association of SC's
Business License Handbook

www.masc.sc

keywords: business license,
SC Business Licensing Officials Association

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Insurance Tax Program

The Insurance Tax Program consolidates the licensing procedures for insurance companies and standardizes rates and dates. Participating municipalities adopt a standard ordinance for insurance company business license taxes. The Association gathers the required insurance business license tax payments on behalf of participating municipalities. This is a 0.75% tax to life insurance companies and a 2.0% tax to property, casualty, and title insurance companies.

Learn more about the Insurance Tax Program by visiting www.masc.sc

(keyword: ITP)

Brokers Tax Program

Insurance companies not licensed to directly sell policies in the state can provide coverage through South Carolina licensed brokers. These brokers provide insurance for unusual risks. Businesses pay the 6% municipal brokers premium tax to the SC Department of Insurance. It then remits 2% to the Municipal Association to distribute to cities and towns.

Learn more about the Brokers Tax Program by visiting www.masc.sc

(keyword: BTP)

Excerpts from the Business License Handbook

www.masc.sc

keywords: Business License Handbook

Insurance Companies and Agents

Municipal Taxation - page 31

The Municipal Association's Local Revenue Services program collects participants' current and delinquent license taxes on gross premiums from domestic and foreign insurance companies. The Municipal Association also serves as the municipal agent to receive and distribute to South Carolina municipalities the municipal portion of the brokers' premium tax for non-admitted insurers collected by the SC Department of Insurance. As such, taxing jurisdictions that participate in the Local Revenue Services program do not directly administer or collect the business license tax on insurers.

On the other hand, taxing jurisdictions may administer and collect business license taxes on agents for insurers licensed to do business in the state, if the local ordinance so provides. The Municipal Association's model ordinance provides, in the text for Class 8.4 in Appendix A, that independent agents, brokers, and their employees are subject to a business license tax based on their natural class.

Although Local Revenues Services administers and collects the business license tax on insurers, for information, this handbook includes the rules followed by Local Revenue Services with respect to insurers. Insurance companies operating within a municipality are subject to business license taxes measured by the gross premiums collected, except that bail bond insurers may deduct amounts retained by a licensed bail bondsman for authorized commissions, fees and expenses. *SC Code Sec. 38-7-20(A)(2)(b)*. The municipality may levy the license tax measured by the premiums collected by the insurance company through an office in the municipality, or on risks located in the municipality, regardless of whether an office or an agent is maintained therein. Payment of state taxes to the Department of Insurance does not exempt insurance companies from municipal taxes. Nothing in the insurance laws prevents municipal business license taxes. *SC Code Sec. 387160*.

- a) **Doing business:** Out-of-state insurance companies that have no agents or offices within the city are not exempt from the license tax on the basis that they are either not "doing business" or are engaged in interstate commerce. The insuring of a risk located within the city, the collection of premiums on that risk in any manner, and the adjustment of claims on policies constitutes "doing business." Collecting premiums exclusively by mail would make no difference.

Support for this position may be found in the U.S. Supreme Court case of *Equitable Life Society v. Pennsylvania*, 238 U.S. 143 (1915), and in *City of New Orleans v. Kansas City*

Life Ins. Co., 22 So. 2d 51 (1945). South Carolina insurance statutes require that insurance business be conducted in this state through licensed agents, managers and adjusters. *SC Code Sec. 384360*.

- b) **Interstate commerce not exempt:** *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408 (1946), held that Congress expressly left to the states the regulation and taxation of insurance companies by the McCarran-Ferguson Act, *15 U.S.C. Sec. 1011*. Insurers in interstate commerce may be taxed. A 1991 unreported decision in the federal District Court for South Carolina held that a mail-order insurer in interstate commerce could be taxed, but an interstate commerce exemption in the ordinance prevented taxation. All participants in the Local Revenue Services program have removed exemptions for interstate commerce from their ordinances. Under the decision in *City of Charleston v. Government Employees Insurance Company*, 334 SC 67, 512 S.E.2d 504 (1999), mail-order insurance companies with no offices in the state are subject to municipal business license taxes on gross premiums collected in the municipality or realized from risks located in the municipality as authorized by *SC Code Sec. 38-7-160*.
- c) **Fire insurance:** Fire insurers are placed in a separate licensing category. Municipalities may base the license of fire insurers or their agents only on premiums from risks located within the municipal limits or premiums collected within the municipality on risks located outside the limits of the municipality. *SC Code Sec. 387160*. When a risk is determined to be located within a municipality, the fire insurer should pay business license taxes on those premiums to that municipality. When a risk is determined to be located outside a municipality, the fire insurer should determine where the premiums for those risks were collected. If the premiums are collected within a municipality, then the business license tax is due to that municipality.

For most municipalities, the business license on fire insurance premiums cannot exceed 2%. Cities with a population of 50,000 or more cannot exceed 5%.

Nothing in the state insurance laws may be “construed as preventing any municipality from levying and collecting license fees or taxes in accordance with its ordinances.” *SC Code Sec. 387160*.

- d) **Classification:** Casualty companies and life insurance companies may be placed into different rate categories. The Supreme Court has consistently upheld reasonable classifications, provided that all companies of the same general type are treated alike. In *City of Columbia v. Putnam*, 241 SC 195, 199, 127 S.E.2d 631, 633 (1962), the Court held:

(A)n ordinance setting the amount of license taxes on a percentage of gross premiums as provided for in the present ordinance in respect to casualty companies is not invalid in that (the) . . . Casualty Insurance Company is treated equally with other casualty companies in the same class. The fact that one class

may pay more proportionately than other classes does not of itself make the license tax unreasonable or arbitrary since this is largely within the discretion of City Council.

e) **Reasonableness of rates:** In *U.S. Fidelity and Guaranty Co. v. City of Spartanburg*, 263 SC 169, 209 S.E.2d 36 (1974), U.S. Fidelity and Guaranty paid 2% of gross income while other businesses paid much less. The Court stated that a gross disparity between license taxes laid on different classifications of business is constitutionally impermissible unless there is a rational basis.

The city defended the disparity on two grounds: first, that fire and casualty insurers receive more benefit than other businesses from two of the city's most expensive and efficient services, fire and police protection; and second, such insurers pay little, if any, *ad valorem* property tax, so they should contribute substantially to the cost of city government by the business license tax. The Supreme Court concluded that the reasons given by the city were not irrational, nor was the resulting rate palpably unreasonable.

The burden is on the challenger to prove a lack of a rational basis. However, a municipality should be able to show why it charges one business class more than another. In doing so, the municipality should consider factors such as the net profit index of one business class as compared to another, the amount of other taxes paid, if any; and the service and protection given by the city to one business class as compared with other categories of business.

County Taxation Prohibited – page 33

Counties are prohibited from levying a business license tax on insurance companies. *SC Code Sec. 4-9-30(12)*.

Insurance Agents – page 34

For business licensing purposes, municipalities must distinguish between licensing of insurers and licensing independent agents who sell or broker insurance products. As noted above, business licensing of insurance companies is regulated by state law, and the business license tax on insurance companies is administered and collected by the Municipal Association's Local Revenue Services program. The business licensing of insurance companies extends to direct employees of such companies who sell insurance; these employees are exempt from additional business license taxes. *Hay v. Leonard*, 212 SC 81, 46 S.E.2d 653 (1948). Payment of license taxes by insurance companies, however, does not exempt independent agents or brokers from license taxes.

The tax on the insurance companies is on the privilege of insuring risks in the municipality. The tax on the independent agents is on the privilege of selling insurance and handling claims. These are two different business activities conducted by two different entities. Whether the

agent sells for one or many companies does not determine whether he is subject to the tax. The test is whether the agent is an employee or an independent agent. An employee's paycheck would include payroll deductions for income taxes and Social Security. The independent agent or broker would receive a commission that would be the agent's or broker's gross income for business license purposes.

In short, municipalities that participate in the Local Revenue Services program should directly license and charge only independent insurance agents and brokers. Local Revenue Services will license and charge insurance companies and their employees, and remit the proceeds to the municipal participants on a periodic basis.

Independent insurance agents sometimes argue that they should not pay a business license tax because the insurance company pays a tax on the gross premiums. They contend this would be double taxation because their commissions are paid from gross premiums. This is a misconception.

Some points to consider in support of taxation of agents:

- Agents are in business, just like other people who contract to perform a service. They contract with insurance companies to sell policies.
- It is unfair to tax other businesses and exempt agents. Other businesses must carry a heavier burden to support the city budget when a class of business is exempt from the tax. Other types of agents and brokers are taxed.
- Tax payments by insurance companies do not come from the commission income received by agents for the sale of policies. The companies do not pay license taxes for agents.
- There is no double taxation. The taxes are levied on two different businesses. For example: manufacturers, wholesalers and retailers may be subject to license taxes on gross income from the sales of the same goods because each activity is a separate business. Neither the goods nor the sales transactions are the subjects of the tax.
- The tax is due for the privilege of doing business. Although it is measured by gross income, it is not an income tax or a premium tax.

Insurance Brokers – page 35

The South Carolina General Assembly, to ensure consistency with the federal Non-admitted and Reinsurance Reform Act of 2010, ratified Act 283 on June 28, 2012, amending *SC Code Secs. 38-7-16 and 38-45-10 through 38-45-195*. The Act establishes a blended broker's premium tax rate of 6%, comprising a 4% state broker's premium tax and a 2% municipal broker's premium tax. A municipality may not impose on brokers of non-admitted insurance in South Carolina an additional license tax based upon a percentage of premiums, as was the practice prior to the passage of these federal and state laws.

Pursuant to *SC Code Secs. 38-45-10 and 38-45-60*, the Municipal Association of SC may, by agreement with a municipality, be designated the municipal agent for purposes of

administration of the municipal broker's premium tax. The Municipal Association's Local Revenue Services program provides this service to its participants. The SC Department of Insurance is required to collect the broker's premium tax and distribute to municipalities the municipal portion of the tax. As the municipal agent, Local Revenue Services receives the entire amount from the SC Department of Insurance and then distributes the funds to the municipalities.

Real Estate

Leasing – page 40

Gross rents from the leasing of real estate, commercial or residential, constitute business income for computing a license tax. The type of tenant is immaterial. There is no interstate commerce involved in local leasing to an out-of-state firm. Some municipalities classify and exempt owners of less than a certain number of leased units from the tax. Others exempt owners with less than a threshold amount of rental income. This is done to avoid a tax on people who are not really in the business but have a small personal investment. Such an exemption is not required by law. It must have a rational basis if granted by ordinance.

Operation – page 41

The operation of buildings, developments, projects, complexes, malls or other such facilities is a business. The gross receipts of the operator, who may also be the owner, is used to compute the tax. If the operator is also the owner, rents plus any other charges collected from tenants should be included.

Sales - page 41

Sales of real property may be made by owners, brokers, or salesmen.

- a) **Owner Sales:** Sales of real estate by owners are subject to license taxes if the owners are in the business of selling real estate. A single or occasional sale by an owner as a personal investment transaction would not be a business. It may be necessary to get information on the frequency of sales and how the owner reports proceeds on income tax returns to determine whether he is in the business of selling real estate.

The full sale price with no deductions for mortgages, commissions, closing costs or purchase cost to the owner is the amount intended to be used to compute the license tax. Taxing jurisdictions should carefully review the language of their ordinances to avoid unintentional incorporation by reference of other state or federal income tax definitions of gross income. *Olds v. Goose Creek*, 424 SC 240, 818 S.E.2d 5 (2018).

- b) **Broker Sales:** Commissions received by real estate brokers constitute gross income for license purposes. If commissions are divided with other brokers or salesmen, as frequently occurs, only the amount retained by a broker is considered income to him. *SC Code Sec. 6-1-400(E)(1)(b)*.

Brokers-In-Charge - page 41

Business licenses must be charged to the broker-in-charge. Notwithstanding any other provision of law, the governing body of a county or municipality may not impose a license, occupation, or professional tax or fee upon real estate licensees, except upon the broker-in-charge at the place where the real estate licensee shall maintain a principal or branch office. The license, occupation or professional tax or fee shall permit the broker-in-charge and the broker's affiliated associate brokers, salespersons, and property managers to engage in all the brokerage activities described in Title 40, Chapter 57 without further licensing or taxing, other than the state licenses issued pursuant to such Chapter or other provisions of law. No license, occupation or professional tax or fee shall be required of the affiliated associate brokers, salespersons, or property managers of a broker-in-charge for such gross receipts upon which a license, occupation or professional tax or fee has already been paid. *SC Code Sec. 6-1-315*.

Brokered transactions of real property in counties or municipalities, other than those in which the broker-in-charge maintains a principal or branch office, create a nexus for imposition of a license, occupation, or professional tax or fee only with respect to gross receipts derived from transactions of property located in that county or municipality. *Section 6-1-315*.

Possible Reductions – page 42

If the person or business taxed pays a business license tax to another county or municipality where the income is earned, the gross income for the purpose of computing the tax must be reduced by the amount of gross income taxed in the other county or municipality. *SC Code Sec. 6-1-400(E)(1)(a)*; see also *SC Code Secs. 5-7-30 (for municipalities) and 4-9-30(12) (for counties)*.