STATE OF TENNESSEE
DEPARTMENT OF COMMERCE AND INSURANCE
OFFICE OF LEGAL COUNSEL
500 JAMES ROBERTSON PARKWAY
DAVY CROCKETT TOWER
NASHVILLE, TENNESSEE 37243
TELEPHONE: (615) 532-6830 FAX: (615) 741-4000

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J. Leigh Griffith, Esq.
Waller, Lansden, Dortch & Davis, LLP
511 Union Street, Suite 2700
Nashville, TN 37219-8966
(615) 244-6380
leigh.griffith@wallerlaw.com

Re: **Interpretive Opinion 02-16, Extended Warranty Service Contracts**

Dear Mr. Griffith:

The Division of Insurance ("Division") of the Tennessee Department of Commerce and Insurance is in receipt of your request for an interpretive opinion. Your inquiry requested guidance on a prospective captive insurance company directly issuing extended warranty service contracts.

Specifically, you posed these questions to the Division:

1) Whether the Division would consider an extended warranty service contract issued by a captive insurance company or other non-insurance entity to be subject to premium tax under Tenn. Code Ann. § 56-4-205 or § 56-13-114.

2) Whether the assumption of financial obligations of existing extended warranty service contracts by an authorized or unauthorized company or association from the captive or another company would be subject to premium taxes under either Tenn. Code Ann. §§ 56-4-205 or 56-13-114.

3) Whether a captive insurance company would be able to maintain its certificate of authority from the Department if it received revenue from the non-insurance business of issuing and holding extended warranty service contracts that exceeds the amount of insurance premium received by the captive.

I. Extended Warranty Service Contracts Are Not Subject to Premium Tax

Taxes are paid by captive insurance companies to the Department on premiums collected or contracted for and are governed under Tenn. Code Ann. § 56-13-114 on all insurance lines lawfully issued under the authority of Tenn. Code Ann. § 56-13-103(a). These statutes limit

such a tax only to insurance premiums received by the company and do not apply any additional tax on other non-insurance revenues that a licensed insurance company may receive in the course of doing business.[1] In the matter of extended warranty service contracts, Tenn. Code Ann. § 56-2-126(a) states:

> The marketing, sale, offering for sale, issuance, making, proposing to make and administration of a service contract shall not be construed to be the business of insurance and shall be exempt from regulation as insurance pursuant to this title.

Accordingly, a captive insurance company that, in addition to issuing insurance policies, also issued extended warranty service contracts as part of its investment policy, *see* Tenn. Code Ann. § 56-13-111(b), would not be liable for the payment of premium taxes on any revenue received in consideration for such contracts provided that the extended warranty service contract in question satisfied the definition of such as found in Tenn. Code Ann. § 56-2-126(6). Likewise, a non-insurance entity that issued extended warranty service contracts meeting the statutory definition would not be liable for the payment of premium taxes. However, a captive insurance company would be liable for premium tax on premium collected on a warranty reimbursement insurance policy issued to the holder of an extended warranty service contract.

In addition, you also asked whether a captive insurance company would be subject to premium tax under Tenn. Code Ann. § 56-4-205, the premium tax statute on traditional insurance companies. Captive insurance companies are exempt from the application of the premium tax on traditional insurance companies. Tenn. Code Ann. § 56-13-116.

II. Direct Assumption of Extended Warranty Service Contracts Are Not Subject to Premium Tax

As stated above, a captive insurance company that, as part of its investment policy, directly assumes extant extended warranty service contracts, would not be liable for the payment of insurance premium taxes on those contracts. The operative difference is whether the captive insurance company is directly acquiring the extended warranty service contracts as part of its investment portfolio or whether the company is issuing an insurance policy to the holder of such a contract to indemnify their risk of loss. Tenn. Code Ann. § 56-13-114 only places a premium tax obligation on the insurance product and not on the investment activity.

III. There Is No Prohibition Against a Captive Insurance Company Receiving Revenue from Non-Insurance Sources That Exceeds Its Insurance Revenue

You have asked whether a captive insurance company could maintain its certificate of authority with the Department if the revenue from directly issuing or acquiring extended warranty service contracts exceeded insurance premiums. There is no statutory prohibition against a captive insurance company, in a given year, receiving investment revenue that exceeds the amount of insurance premium collected. This extends to any investment revenue tied to extended warranty service contracts.

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[1] This opinion does not address the liability for any other taxes that may be due to another state agency or to a local government on insurance or non-insurance business activity.

Captive insurance company investments are governed by Tenn. Code Ann. § 56-13-111. Generally, a captive insurance company must file a statement of investment policy and abide by such a policy. Tenn. Code Ann. § 56-13-111(b). Should a captive insurance company wish to invest in extended warranty service contracts, the Department would seek to determine if such investments threaten the solvency or liquidity of the company. *Id.* Should that investment not threaten the solvency or liquidity of the company it would be permitted, even if it did generate revenue in excess of premiums collected.

Notwithstanding the above, the Commissioner retains the discretion on whether to issue a certificate of authority to an applicant captive insurance company. The Department would consider the totality of the application and submitted business plan to determine if a certificate of authority should be issued.

Please note that the Division has not made an independent investigation of the facts to determine the accuracy or completeness of the information supplied, but has instead relied solely upon the information you have provided. If such information is incorrect or changes substantially, it would be necessary for the Division to reconsider the matter and the position stated herein would be void. This letter expresses the Division's position on enforcement action only and does not purport to express legal conclusions on the issues presented. This position is furnished solely for the benefit and use of the entities described herein. Please be advised that further publication or use of this position may only be made with the Division's prior written consent.

This response by the Division is to a specific fact situation relating to Tennessee captive insurance law and should not be construed as a legal position or opinion of the Commissioner of the Tennessee Department of Commerce and Insurance or of any other official in the Department. Please note that the conclusions contained herein are based upon the representations that have been made to the Division, and any different facts or conditions might require a different response. Furthermore, the conclusions contained herein are applicable only to captive insurance companies. The laws and regulations governing captive insurance companies differ significantly from those applicable to traditional insurance companies. As each inquiry is reviewed on the specific facts presented, this response is based only on such facts and may not be used as precedent by any person or entity. Any variation in the facts presented to the Division by Mr. Leigh Griffith could result in a different conclusion than asserted herein.

If you have further questions or concerns regarding this letter, please feel free to contact me.

Benjamin A. Whitehouse, BPR # 22341
Assistant General Counsel
Department of Commerce and Insurance
Davy Crockett Tower
500 James Robertson Parkway
Nashville, TN 37243
615-741-2616
ben.whitehouse@tn.gov