

1 **FINDINGS OF FACTS**

2 **Company Reorganization**

3 1. As a result of a federal corporate tax-free reorganization pursuant to
4 USCA, Title 26, Subtitle A, Ch. 1, Subch. C, Pt. III, several assumption reinsurance
5 agreements and stock purchase agreements mentioned below, on or about July 20,
6 1990, NN Investors Life Insurance Company ("NN Investors") became the successor,
7 for federal tax purposes, of two affiliated insurers, NOLIC and Pacific Fidelity.

8 2. The income tax-free reorganization was undertaken for several
9 legitimate business reasons, including the consolidation of certain lines of business
10 within the AEGON group of companies.

11 3. On July 16, 1990, Mr. Craig D. Vermie wrote a letter to the Department
12 regarding the reorganization of NN Investors, Pacific Fidelity, and NOLIC. (See PFL
13 Exhibit D.)

14 4. On July 20, 1990, NOLIC entered into an Assumption Reinsurance
15 Agreement (the "NOLIC Agreement") with NN Investors, concerning insurance
16 policies written in Arizona and other jurisdictions. Prior to that agreement, NOLIC and
17 NN Investors were each indirect subsidiaries of AEGON USA, Inc. ("AEGON").

18 5. Section 3 of the NOLIC Agreement provided that NN Investors assumed
19 all existing and subsequent liability to policyholders, beneficiaries, and supplementary
20 -contract holders growing out of the reinsured policies.

21 6. Under Section 4 of the NOLIC Agreement, NOLIC transferred and
22 assigned to NN Investors all receivables that were due, or became due, with respect
23 to the reinsured policies and liabilities assumed by NN Investors.

24 7. Under Section 6 of the NOLIC Agreement, NN Investors did not assume
25 any corporate obligations or liability of NOLIC arising after the effective time of
26 reinsurance, except for the rights, liabilities, and obligations arising out of the
27 reinsured business. (See PFL's Exhibit A.)

28 8. On July 20, 1990, Pacific Fidelity and NN Investors entered into an
29 agreement (the "Pacific Fidelity Agreement") concerning insurance policies written by
30 Pacific Fidelity in Arizona and other jurisdictions. Prior to that agreement, Pacific

1 Fidelity and NN Investors were each indirect subsidiaries of AEGON.

2 9. Section 3 of the Pacific Fidelity Agreement provided that NN investors
3 assumed all existing and subsequent liability to policyholders, beneficiaries, and
4 supplementary-contract holders growing out of the reinsured policies.

5 10. Under Section 4 of the Pacific Fidelity Agreement, Pacific Fidelity
6 transferred and assigned to NN Investors all receivables that were due or became
7 due, with respect to the reinsured policies and liabilities assumed by NN Investors.

8 11. Under Section 6 of the Pacific Fidelity Agreement, NN Investors did not
9 assume any corporate obligations or liability of Pacific Fidelity arising after the
10 effective time of reinsurance except for the rights, liabilities and obligations arising out
11 of the reinsured business. (See PFL's Exhibit C.)

12 12. On January 1, 1991, NN Investors amended its Articles of Incorporation,
13 and changed its name to PFL Life Insurance Company ("PFL/Petitioner"). (See PFL's
14 Exhibit E.)

15 13. Under the agreements described above in paragraphs 4 and 8, the
16 business of Pacific Fidelity and NOLIC was transferred to NN Investors. However, the
17 corporate charters and certificates of authority of Pacific Fidelity and NOLIC remained
18 intact with each of those legal entities maintaining the minimum capital and surplus
19 necessary to maintain its authority to do business.

20 14. On December 12, 1990, the California Insurance Commissioner
21 consented to both the Assumption Agreement between Pacific Fidelity and NN
22 Investors and the Assumption Agreement between NOLIC and NN Investors. (See
23 PFL's Exhibit F.)

24 15. On August 14, 1990, the Iowa Department of Insurance approved the
25 above-mentioned reorganization. (See PFL's Exhibit G.)

26 16. On November 30, 1990, the Arkansas Insurance Department approved
27 the above-mentioned reorganization. (See PFL's Exhibit I.)

28 17. On May 27, 1992, Protective Life Insurance Company ("Protective Life"),
29 AUSA Life Insurance Company ("AUSA"), and AEGON entered into a Stock Purchase
30 Agreement. At that time, AUSA owned all of the outstanding stock of NOLIC.

1 Pursuant to that agreement, Protective Life purchased the corporate charter and
2 certain assets of NOLIC required to maintain NOLIC's certificates of authority and
3 licenses to do business in 48 States, one of which is Arizona. (See PFL's Exhibit 00.)

4 18. On July 30, 1992, PaineWebber Life Holdings, Inc. ("PaineWebber"),
5 AUSA and AEGON entered into a Stock Purchase Agreement. At that time, AUSA
6 owned all of the of the outstanding stock in Pacific Fidelity. Under that agreement,
7 PaineWebber purchased the corporate charter and certain assets of Pacific Fidelity
8 required to maintain Pacific Fidelity's certificates of authority and licenses to do
9 business in 48 states, one of which is Arizona. (See PFL Exhibit B.)

10 **Premium Tax Returns and the Department's Audits**

11 19. PFL filed with the Department a Foreign and Alien Life and/or Disability
12 Insurer, Annual Premium Tax and Fees Report, due March 1, 1993, for the Calendar
13 Year 1992. The summary of taxes and fees due March 1, 1993, includes:

| | | |
|----|--------------------------------------|-------------|
| 14 | Retaliatory amount | \$ 3,595.25 |
| 15 | Certificate of Authority Renewal Fee | 69.75 |
| | Annual Statement Filing Fee | 155.00 |
| 16 | Total Due: | \$ 3,820.00 |

17 The total gross Arizona premium taxes was \$210,294.00. The claimed Guaranty
18 Fund premium tax offset was \$151,832.00. The 1992 installment taxes paid were
19 \$88,626.00. The overpayment of Arizona premium taxes was \$30,164.00. (See
20 Department's Exhibit 9.)

21 20. PFL filed with the Department a Foreign and Alien Life and/or Disability
22 Insurer Annual Premium and Tax Fees Report, due March 1, 1994, for the Calendar
23 Year of 1993. The summary of taxes and fees due March 1, 1994, includes:

| | | |
|----|---|-------------|
| 24 | Retaliatory Amount | \$ 3,627.00 |
| | Certificate of Authority Renewal Fee | 83.25 |
| 25 | Certificate of Authority 10% Surcharge (Computer fund) | 8.32 |
| 26 | Annual Statement Filing Fee | 185.00 |
| 27 | Total Due March 1, 1994: | \$ 3,903.57 |

28 The total gross Arizona premium taxes were \$216,229.00. The claimed Guaranty
29 Fund tax offset was \$232,302.00. The 1993 installment taxes paid were \$52,614.00

1 and the claimed overpayment of Arizona premium taxes was \$52,614.00. (See
2 Department's Exhibit 8.)

3 21. As the result of an audit, on June 3, 1994, the Department forwarded a
4 letter to PFL regarding the refund of the 1993 premium tax overpayment. The
5 Department determined that PFL was owed a refund of \$22,426.12 for premium
6 taxes. The audit reduced the claimed Guaranty Fund tax offset to \$186,040.74. This
7 was based on the assessment amounts from the assessments dated September 1,
8 1989, July 20, 1990, December 14, 1990, October 30, 1992, December 23, 1992, and
9 November 5, 1993. (See PFL's Exhibit V.)

10 22. For the calendar year 1994, PFL filed with the Department a Foreign
11 and Alien Life and/or Disability Insurer-Annual Premium Tax and Fees Report, due
12 March 1, 1995. There was no retaliatory tax and no premium tax due. The fees due
13 includes:

| | |
|---|-----------|
| Certificate of Authority Renewal Fee | \$ 87.75 |
| Certificate of Authority 10% Surcharge (Computer fund) | 8.78 |
| Annual Statement Filing Fee | 195.00 |
| Total Due March 1, 1995: | \$ 291.53 |

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18 Total gross Arizona premiums were \$208,264.00. The claimed Guaranty Fund credit
19 was \$228,729.00 and the 1994 installment taxes paid were \$27,168.00. The claimed
20 overpayment of Arizona premium taxes was \$27,168.00. (See Department's Exhibit
21 7.)

22 23. As a result of an audit, on June 5, 1995, the Department forwarded a
23 letter to PFL regarding the 1994 premium tax refund. The Department determined
24 that PFL would be refunded \$26,914.13 for overpayment of the premium tax. The
25 audit determined that the claimed Guaranty Fund tax offset was \$225,635.15. This
26 amount was based on the Assessments dated September 1, 1989, July 2, 1990,
27 December 14, 1990, October 30, 1992, December 23, 1992, November 5, 1993, and
28 August 15, 1994. (See PFL's Exhibit AA.)

29 24. For the Calendar Year 1995, PFL filed with the Department a Foreign
30 and Alien and/or Life and Disability Insurer, Annual Premium Tax and Fees Report,

1 due March 1, 1996. There was no retaliatory tax due and no premium tax due. The
2 fees due included:

| | | |
|---|--------------------------------------|-----------|
| 3 | Certificate of Authority Renewal Fee | \$ 101.25 |
| 4 | Annual Statement Filing Fee | 225.00 |
| 5 | Total Due March 1, 1996: | \$ 326.25 |

6 The total gross Arizona Premium taxes were \$196,175.18. The claimed Guaranty
7 Fund credit was \$383,224.00. (See Department's Exhibit 6.)

8 25. The Department conducted an audit of PFL for the tax year of 1995.
9 This audit found that PFL did not owe any premium tax. It did, however, find that PFL
10 owed \$3,884.00 in retaliatory tax. (See PFL's Exhibit EE.)

11 26. PFL filed with the Department a Foreign and Alien Life and/or Disability
12 Insurer Annual Premium Tax and Fees Report due March 1, 1997 for the Calendar
13 Year of 1996. The fees due included:

| | | |
|----|--------------------------------------|-------------|
| 14 | Retaliatory Tax | \$ 5,257.75 |
| 15 | Certificate of Authority Renewal Fee | 101.25 |
| 16 | Annual Statement Filing Fee | 225.00 |
| 17 | Total Due March 1, 1997: | \$ 5,584.00 |

18 The gross Arizona premium tax was \$199,430.00. The claimed total available
19 Guaranty Fund Tax offset was \$360,578.00. (See Department's Exhibit 5.)

20 27. For the Calendar Year of 1997, PFL filed with the Department a Foreign
21 and Alien Life and/or Disability Insurer Annual Premium Tax and Fees Report, due
22 March 1, 1998. The fees due included:

| | | |
|----|--------------------------------------|-------------|
| 23 | Retaliatory Tax | \$ 8,785.15 |
| 24 | Certificate of Authority Renewal Fee | 101.25 |
| 25 | Annual Statement Filing Fee | 225.00 |
| 26 | Total Due March 1, 1998: | \$ 9,111.40 |

27 The gross Arizona premium taxes was \$187,596.48. The claimed total available
28 Guaranty Fund tax offsets was \$363,836.00. (See Department's Exhibit 4.)

29 **Assessments And Payments**

30 28. The following is a summary of the date of assessment, company
assessed, and amount assessed that is more fully explained below:

| DATE OF ASSESSMENT | COMPANY ASSESSED | AMOUNT ASSESSED | DATE PAID BY PFL or NN INVESTORS |
|--------------------|-------------------------------------|-----------------|----------------------------------|
| 9-1-89 | NN Investors | \$ 111,440.42 | 10-10-89 |
| 7-2-90 | NN Investors | 67,548.23 | 9-7-90 |
| 8-15-91 | NN Investors | 87,903.15 | 10-10-91 |
| 8-15-91 | National Old Line Insurance Company | 5,818.50 | 8-21-91 |
| 8-19-91 | Pacific Fidelity | 1,204,780.73 | 10-12-91 |
| 10-30-92 | PFL | 173,746.21 | 11-16-92 |
| 10-30-92 | Pacific Fidelity | 3,367.63 | 11-12-92 |
| 10-30-92 | Pacific Fidelity | .78 | 1-11-93 |
| 12-23-92 | | | |
| 11-12-93 11-5-93 | PFL | 4,247.55 | 11-23-93 |
| 11-12-93 11-5-93 | Pacific Fidelity | .66 | 11-23-93 |
| 8-15-94 | PFL | 68,169.45 | 9-2-94 |
| 7-14-95 | PFL | 122,099.13 | 7-27-95 |
| 7-14-95 | PaineWebber | 34,581.76 | 8-3-95 |
| 8-1-96 | PaineWebber | 5,000 | 9-4-96 |
| 12-27-96 12-31-96 | PFL | 109,459.47 | 3-17-97 |

29. On September 1, 1989, the Guaranty Fund issued a Notice of Assessment to NN Investors in the amount of \$111,440.42, for the payment of the unpaid contractual obligations of Diamond Benefits Life Ins. Company. (See Exhibit 1 attached to the Joint Statement of Stipulated Facts.)

30. On October 10, 1989, NN Investors issued check number 570171 to the Guaranty Fund in the amount \$111,440.42 in response to the Assessment referred to above in paragraph number 29. (See Exhibit 2 attached to the Joint Statement of Stipulated Facts.)

31. On October 18, 1989, the Guaranty Fund issued a certificate of contribution to NN Investors with respect to the Assessment referred to in paragraph number 29. The certificate of contribution was in the amount of \$111,440.42. The premium tax credits were amortized for tax years 1989-1995. (See Exhibit 3 attached to the Joint Statement of Stipulated Facts.)

32. On July 2, 1990, the Guaranty Fund issued a Notice of Assessment to NN Investors in the amount of \$67,548.23. (See Exhibit 4 attached to the Joint Statement of Stipulated Facts.)

1 33. On July 13, 1990, the Guaranty Fund issued a certificate of contribution
2 to NOLIC in the amount of \$1,303.08. The tax credits were amortized. (See Exhibit 5
3 attached to the Joint Statement of Stipulated Facts.)

4 34. On September 7, 1990, NN Investors issued check number 760984 to
5 the Guaranty Fund in the amount of \$67,548.23 to pay its July 2, 1990 Assessment.
6 (See Exhibit 6 attached to the Joint Statement of Stipulated Facts.)

7 35. On September 11, 1990, the Guaranty Fund issued a certificate of
8 contribution to NN Investors with respect to the Assessment referred to above in
9 paragraph 26. The certificate of contribution was in the amount of \$67,548.23. The
10 premium tax credits were amortized for tax years 1990-1996. (See Exhibit 7 attached
11 to the Joint Statement of Stipulated Facts.)

12 36. On August 15, 1991, the Guaranty Fund issued a Call of Assessment to
13 NN Investors in the amount of \$87,903.15. (See Department's Exhibit 4.)

14 37. On October 10, 1991, PFL issued check number 1035515 in the amount
15 of \$87,903.15 to the Guaranty Fund for the August 15, 1991, Call of Assessment to
16 NN Investors. (See Department's Exhibit 4.)

17 38. On October 15, 1991, the Guaranty Fund issued a certificate of
18 contribution to NN Investors with respect to the Assessment referred to above in
19 paragraph 30. The premium tax credits were amortized for tax years 1991-1997.
20 (See Exhibit 8 attached to the Joint Statement of Stipulated Facts.)

21 39. On August 15, 1991, NOLIC was assessed \$5,818.50 by the Guaranty
22 Fund. (See Exhibit 9 attached to the Joint Statement of Stipulated Facts.)

23 40. On August 21, 1991, PFL issued check number 0659182 to the
24 Guaranty Fund in the amount of \$5,818.50 for the 1991 Assessment of NOLIC. (See
25 Department's Exhibit 4.)

26 41. On October 3, 1991, the Guaranty Fund issued a certificate of
27 contribution to NOLIC with respect to the Assessment referred to above in paragraph
28 33. The premium tax credits were amortized for tax years 1991-1997. (See Exhibit
29 10 attached to the Joint Statement of Stipulated Facts.)
30

1 42. On August 15, 1991, the Guaranty Fund issued a Call of Assessment to
2 Pacific Fidelity in the total amount of \$1,204,780.73. (See Exhibit 11 attached to the
3 Joint Statement of Stipulated Facts.)

4 43. On October 12, 1991, PFL issued check number 1043779 to the
5 Guaranty Fund in the amount of \$1,204,780.73 for the August 19, 1991 Assessment
6 of Pacific Fidelity. (See Exhibit 12 attached to the Joint Statement of Stipulated
7 Facts.)

8 44. On October 24, 1991, the Guaranty Fund issued a Certificate of
9 Contribution to Pacific Fidelity with respect to the Assessment referred to above in
10 paragraph 36. The premium tax credits were amortized for tax years 1991-1997.
11 (See Exhibit 13 attached to the Joint Statement of Stipulated Facts.)

12 45. On October 30, 1992, the Guaranty Fund issued a Notice and Call to
13 PFL for a portion of the Assessment due from PFL. The total amount assessed was
14 \$173,746.21. (See Department's Exhibit 4.)

15 46. On November 16, 1992, PFL issued check number 1342452 to the
16 Guaranty Fund in the amount of \$173,746.21 for the assessment identified above in
17 paragraph 39. (See Department's Exhibit 4.)

18 47. On November 23, 1992, the Guaranty Fund issued a certificate of
19 contribution to PFL with respect to the Assessment referred to above in paragraph 39.
20 (See Exhibit 14 attached to the Joint Statement of Stipulated Facts.)

21 48. On October 30, 1992, the Guaranty Fund issued a Notice and Partial
22 Call of Assessment to Pacific Fidelity in the total amount of \$3,367.63. (See
23 Department's Exhibit 4.)

24 49. On November 12, 1992, PFL issued check number 1339361 in the
25 amount of \$3,367.63 to the Guaranty Fund for the October 30, 1992, Assessment of
26 Pacific Fidelity. (See Department's Exhibit 4.)

27 50. On November 17, 1992, the Guaranty Fund issued a certificate of
28 contribution to Pacific Fidelity with respect to the Assessment referred to above in
29 paragraph 42. (See Exhibit 15 attached to the Joint Statement of Stipulated Facts.)
30

1 51. The Guaranty Fund issued a Call of Assessment, Annuity Account Only
2 - Noticed October 30, 1992, Call Date December 23, 1992, in the amount of \$.78 to
3 Pacific Fidelity. (See Exhibit 16 attached to the Joint Statement of Stipulated Facts.)

4 52. On January 11, 1993, PFL issued check number 02005995 to the
5 Guaranty Fund in the amount of \$.78 for the October 30, 1992, Assessment of Pacific
6 Fidelity. (See, Exhibit 17 attached to the Joint Statement of Stipulated Facts.)

7 53. On January 29, 1993, the Guaranty Fund issued a certificate of
8 contribution to Pacific Fidelity with respect to the Assessment referred to in paragraph
9 51. (See Exhibit 18 attached to the Joint Statement of Stipulated Facts.)

10 54. The Guaranty Fund issued an Amended November 12, 1993 Notice and
11 Call of Assessment dated November 5, 1993 in the amount of \$4,247.55 to PFL.
12 (See Exhibit 19 attached to the Joint Statement of Stipulated Facts.)

13 55. On November 23, 1993, PFL issued check number 02269978 to the
14 Guaranty Fund in the amount of \$4,247.56 [sic]. (See Exhibit 20 attached to the Joint
15 Statement of Stipulated Facts.)

16 56. On November 29, 1993, the Guaranty Fund issued a certificate of
17 contribution to PFL with respect to the Assessment referred to above in paragraph 54.
18 (See Exhibit 21 attached to the Joint Statement of Stipulated Facts.)

19 57. The Guaranty Fund issued an Amended November 12, 1993 Notice and
20 Call of Assessment, dated November 5, 1993, to Pacific Fidelity in the amount of the
21 \$.66. (See Exhibit 22 attached to the Joint Statement of Stipulated Facts.)

22 58. On November 23, 1993, PFL issued check number 02269977 to the
23 Guaranty Fund in the amount of \$.66 for the Assessment of Pacific Fidelity. (See
24 Exhibit 23 attached to the Joint Statement of Stipulated Facts.)

25 59. On November 29, 1993, the Guaranty Fund issued a certificate of
26 contribution to Pacific Fidelity with respect to the Assessment referred to above in
27 paragraph 57. (See Exhibit 24 attached to the Joint Statement of Stipulated Facts.)

28 60. The Guaranty Fund issued a Notice and Call of Assessment, dated
29 August 15, 1994, to PFL in the amount of \$68,169.45. (See Exhibit 25 attached to the
30 Joint Statement of Stipulated Facts).

1 61. On September 2, 1994, PFL issued check number 02517150 to
2 Guaranty Fund in the amount of \$68,169.45 for the Assessment referred to above in
3 Paragraph 54. (See Exhibit 26 attached to the Joint Statement of Stipulated Facts.)

4 62. On October 11, 1994, the Guaranty Fund issued a certificate of
5 contribution to PFL with respect to the Assessment referred to in paragraph 60. (See
6 Exhibit 27 attached to the Joint Statement of Stipulated Facts.)

7 63. The Guaranty Fund issued a Notice and Call of Assessment, dated July
8 14, 1995, to PFL in the amount of \$122,099.13. (See Exhibit 28 attached to the Joint
9 Statement of Stipulated Facts)

10 64. On July 27, 1995, PFL issued check number 02815248 to the Guaranty
11 Fund in the amount of \$122,099.13 for the Assessment referred to above in
12 paragraph 63. (See Exhibit 29 attached to the Joint Statement of Stipulated Facts.)

13 65. On July 31, 1995, the Guaranty Fund issued a Certificate of Contribution
14 to PFL with respect to the Assessment referred to in paragraph 63. (See Exhibit 30
15 attached to the Joint Statement of Stipulated Facts.)

16 66. The Guaranty Fund issued a Notice and Call of Assessment, dated July
17 14, 1995, to PaineWebber in the amount of \$34,581.76. (See Exhibit 31 attached to
18 the Joint Statement of Stipulated Facts.)

19 67. On August 3, 1995, PFL issued check number 02821010 to Guaranty
20 Fund in the amount of \$34,581.76 for the Assessment of PaineWebber. (See Exhibit
21 32 attached to the Joint Statement of Stipulated Facts.)

22 68. On August 7, 1995, the Guaranty Fund issued a certificate of
23 contribution to PaineWebber with respect to the Assessment referred to above in
24 paragraph 66. (See Exhibit 33 attached to the Joint Statement of Stipulated Facts.)

25 69. The Guaranty Fund issued a billing statement to PaineWebber of the
26 remaining balance due with respect to previous noticed assessments for the years
27 1990, 1991, 1992, 1993, 1994 and 1995, dated August 1, 1996. The amount due
28 was reduced to \$5,000.00 from a higher amount because the assessment could not
29 exceed 2% of PaineWebber's 1995 Arizona premiums. (See Department's Exhibit 4
30 and PFL's Exhibit P.)

1 70. On August 6, 1996, Ronald P. Moden, of PaineWebber, forwarded a
2 letter to Dawn Lawson, AEGON. The letter requests that AEGON pay \$5,000.00 to
3 the Guaranty Fund based on 1991 premiums. (See Department's Exhibit 4 and PFL's
4 Exhibit Q.)

5 71. On September 4, 1996, PFL issued check number 3189449 in the
6 amount of \$5,000.00 to the Guaranty Fund for the Assessments of PaineWebber
7 referred to above in paragraph 69. (See Department's Exhibit 4 and PFL's Exhibit O.)

8 72. On September 9, 1996, the Guaranty Fund issued a Certificate of
9 Contribution to PaineWebber with respect to the billing issued August 1, 1996 referred
10 to above in paragraph 69. (See PFL's Exhibit N.)

11 73. The Guaranty Fund issued a Call for Assessment Notice December
12 27/31, 1996, to PFL in the amount of \$109,459.47. (See PFL's Exhibit M.)

13 74. On March 17, 1997, PFL issued check number 03335688 to the
14 Guaranty Fund in the amount of \$109,459.47 for the Assessment referred to above in
15 paragraph 73. (See PFL's Exhibit L.)

16 75. On March 20, 1997, the Guaranty Fund issued a certificate of
17 contribution to PFL with respect to the Assessment referred to above in paragraph 67.
18 (See PFL's Exhibit K and the Department's Exhibit 4.)

19 76. On July 17, 1998, the Department forwarded a premium tax audit recap
20 to PFL, asserting that premium taxes were delinquent in accordance with A.R.S. § 20-
21 224. The Department, in its July 17, 1998 letter, states that "the majority of the
22 assessment is due to disallowed Guaranty Fund offsets."

23 77. The Department has a policy that certificates of contribution may be
24 claimed when the corporation to which they are issued merges into another
25 corporation, but not when the certificates are transferred to another corporation and
26 the certificate of authority to transact the business of insurance continues to exist.

27 78. The total amount the Department determined due from Petitioner is
28 \$966,341.32, consisting of \$690,903.36 in tax, \$35,727.42 in penalty, and
29 \$239,710.54 in interest. This amount includes an \$8.58 retaliatory tax credit for 1993
30 and a \$.61 retaliatory tax due for 1996. PFL is not appealing the retaliatory amounts.

1 79. Kelly Stephens ("Ms. Stephens"), Deputy Assistant Director, Corporate
2 and Financial Division of the Department, reviewed the above-mentioned audits, audit
3 recap, and upheld the determinations to disallow the premium tax offset credits
4 utilized by PFL for the calendar years 1992 through 1997 through the use of
5 certificates of contribution issued to NOLIC and Pacific Fidelity.

6 80. The evidence of record revealed that with respect to PFL's premium tax
7 filing for the years in question, three different revenue auditors for the Department did
8 not disallow Petitioner's use of the certificates of contribution issued to NOLIC and
9 Pacific Fidelity to as premium tax offset credits.

10 81. Ms. Stephens testified that she has been employed with the Department
11 since May 1986, and since that time, the Department has followed a policy of not
12 allowing certificates of contribution to be transferred except in situations involving
13 mergers. According to Ms. Stephens, the Department has consistently applied that
14 policy, although she is unaware of the policy being memorialized in writing.

15 82. A.R.S. 20§-692 addresses the Fund's issuance of certificates of
16 contribution, but does not specifically provide for their transferability.

17 83. To utilize premium tax offset credits, the Department requires an insurer
18 to submit photocopies of certificates of contribution from the Guaranty Fund with the
19 insurer's premium tax return filing.

20 84. According to Ms. Stephens, premium tax offset credits are only given to
21 the insurance company whose name appears on the certificate of contribution. The
22 only exception to that policy is when an insurance company whose name appears on
23 the certificate of contribution merges with the surviving insurer. In that instance, the
24 Department permits the surviving entity to use the certificates of contribution issued to
25 the merged entity to offset the premium tax liability of the surviving entity.

26 85. Ms. Stephens further testified that in cases where there is no merger,
27 such as the instant matter, and the insurers continue to hold a certificate of authority
28 after a tax-free reorganization, the insurers can engage in new insurance
29 transactions. Thus, the insurers have an opportunity to utilize the tax credits in the
30 future. Ms. Stephens opined that if the Department permitted premium tax offset

1 credits to be used by an insurer other than the insurer whose name appears on a
2 certificate of contribution, the Department would have made a mistake.

3 86. According to Ms. Stephens, if Pacific Fidelity or NOLIC were to file for
4 the premium tax offset credits at issue here, the Department would have no legal
5 basis to deny Pacific Fidelity or NOLIC such credit. Therefore, if Pacific Fidelity or
6 NOLIC claimed the same tax credits as Petitioner based upon the same certificates
7 of contribution, the Department would not disallow the credit to NOLIC or Pacific
8 Fidelity. However, the Department could not allow two insurers to use the same
9 certificates of contribution for premium tax offset credit. That is one of the reasons
10 why the Department disallowed Petitioner's use of NOLIC's and Pacific Fidelity's
11 certificates of contribution as premium tax offset credits.

12 87. Ms. Stephens testified that the Department has discretion in this matter as
13 to whether to impose penalties and interest against Petitioner, but decided not to
14 exercise that discretion favorably to the Petitioner.

15 88. According to Ms. Stephens, if Pacific Fidelity or NOLIC were to file for the
16 premium tax offset credits at issue here, the Department would have no legal basis to
17 deny Pacific Fidelity or NOLIC such credit. Therefore, if Pacific Fidelity or NOLIC
18 claimed the same tax credits as Petitioner based upon the same certificates of
19 contribution, the Department would not disallow the credit to NOLIC or Pacific Fidelity.
20 However, the Department could not allow two insurers to use the same certificates of
21 contribution for premium tax offset credit. That is one of the reasons why the
22 Department disallowed Petitioner's use of NOLIC's and Pacific Fidelity's certificates of
23 contribution as premium tax offset credits.

24 89. Ms Stephens' testimony as set forth above is determined to be credible.

25 90. Michael Karal ("Mr. Karal"), employed by Life Investors Insurance Co.,
26 testified on behalf of Petitioner. Life Investors Insurance Co. is a member of AEGON,
27 of which NOLIC, Pacific Fidelity and Petitioner belong. Mr. Karal is a certified public
28 accountant and the manager of tax compliance and financial reporting for all
29 companies within AEGON, including NOLIC, Pacific Fidelity, and PFL.
30

1 91. Mr. Karal credibly testified that the purpose of having all the assets and
2 liabilities of NOLIC and Pacific Fidelity transferred to PFL, but for the minimum capital
3 surplus, was for AEGON to end up with one insurance company, PFL, that would
4 have all of that insurance business. The transfer of assets and liabilities was
5 expected to result in a reduction of costs to AEGON.

6 92. The certificates of contribution issued in the name of NOLIC and Pacific
7 Fidelity for the years at issue were treated, for reporting purposes, as assets in PFL's
8 annual statements for the years 1992 through 1997 that were filed with the
9 Department.

10 93. Other states, such as Iowa and Texas, have allowed PFL to use the
11 certificates of contribution issued in the name of NOLIC and Pacific Fidelity as tax
12 credits.

13 94. The tax-free reorganizations of NOLIC and Pacific Fidelity were
14 accomplished under §369 of the Internal Revenue Code. Mr. Karal testified that this
15 provision pertains to tax-free reorganizations and does not relate to state premium tax
16 obligations.

17 95. James Tait, an expert witness who testified on behalf of Petitioner, is a
18 certified public accountant whose practice has concentrated within the insurance
19 industry. Mr. Tait is also licensed to practice law in Illinois and Alabama. Mr. Tait
20 opined that certificates of contribution are assets, as defined in A.R.S. §20-501, even
21 though they are not specifically identified in the statute. In particular, Mr. Tait testified
22 that the certificates of contribution fall within subsection 10 of that statute, under the
23 classification of "[d]eposits or equities recoverable from underwriting associations,
24 syndicates and reinsurance funds, or from any suspended banking institution, to the
25 extent deemed by the director available for the payment of losses and claims and at
26 values to be determined by him."

27 96. Mr. Tait also opined that the certificates of contribution fall within
28 subsection 11 of A.R.S. §20-501, under the classification of "[a]ll assets, whether or
29 not consistent with the provisions of this section, as may be allowed pursuant to the
30 annual statement from approved by the national association of insurance

1 commissioners for the kinds of insurance to be reported upon therein.”

2 96. Mr. Tait represented that upon his review of the documents pertaining to
3 the tax-free reorganizations of NOLIC and Pacific Fidelity, he does not believe that
4 there was a novation of the contractual obligations of those insurers; i.e. that they still
5 remain contractually liable and are not relieved of those obligations. In that regard,
6 Mr. Tait’s testimony supports the Department’s contention that, because there was no
7 novation, the policyholder obligations that NOLIC and Pacific Fidelity transferred to
8 Petitioner could still be the responsibility of NOLIC and Pacific Fidelity, respectively, if
9 Petitioner was unable to honor those obligations.

10 97. It is determined that, while the policyholder obligations of NOLIC and
11 Pacific Fidelity were transferred to Petitioner, those insurers still have residual ties to
12 those obligations. Therefore, the plausibility of Petitioner’s argument that the
13 certificates of contribution follow the policyholder obligations is diminished because
14 NOLIC and Pacific Fidelity still retain potential liability of those policyholder
15 obligations.

16 98. Mr. Tait credibly testified that if a statute does not authorize the use of
17 the premium tax credit offsets, the certificates of contribution are of no value.

18 **CONCLUSIONS OF LAW**

19 The parties represent that the critical issue in this case is whether certificates of
20 contribution issued by the Guaranty Fund are transferable and can be used by the
21 insurance company acquiring them as premium tax offset credits. In order to
22 determine transferability, one must look to the Arizona statutory scheme relating to
23 certificates of contribution to see whether that issue is addressed or if the Legislature
24 provided guidance as to its intent. Petitioner and the Department raise compelling
25 arguments in support of their respective positions.

26 **Burden of Proof**

27 Petitioner bears the burden of proving by a preponderance of the evidence that
28 the premium tax assessments made by the Department for the years 1992 through
29 1997 are incorrect. See Culpepper v. Pepper, 187 Ariz. 431, 437-438, 930 P2d. 508
30 (Ariz. App. 1996). Therefore, it is incumbent upon the Petitioner to show that it was

1 entitled to utilize the premium tax offset credits. It is not enough, as Petitioner's
2 expert witness testified that arguments can be made in favor of the Petitioner, it bears
3 the burden of demonstrating that its position is more compelling than the
4 Department's and must have persuasive authority in support of its position.

5 Tax deductions are strictly construed and the burden of the right to a claimed
6 deduction is on the taxpayer Indopco v. C.I.R., 503 U.S. 79, ___, 112 S. Ct. 1039, 1043
7 (1992). That rule of strict construction is also applied to tax exemption statutes, such
8 as those involving credits, like A.R.S. §20-692. See Keyes v. Chambers, 209 Or.
9 640, ___, 307 P.2d 498, 501 (Or. 1957.). Petitioner must therefore establish that it is
10 statutorily entitled to the claimed premium tax offset credits it claims. Petitioner fails to
11 present any statutory authority entitling it to use the premium tax offset credits at
12 issue.

13 Petitioner maintains that there is no statutory prohibition in the insurance laws
14 for the transferability of certificates of contribution, and maintains that, as a corporate
15 asset, the certificates are freely transferable under Arizona corporation laws.
16 Although there is no authority that specifically prohibiting the transferability of the
17 certificates, Petitioner cites no specific authority providing for their transferability.

18 **Statutory Construction**

19 The Department construes A.R.S. §20-692 to preclude the transfer of
20 certificates of contribution to be transferable, thereby restricting the use of the
21 premium tax offset credits at issue. That interpretation of A.R.S. §20-692 is entitled to
22 considerable weight. See Copper Queen Consol. Mining Co. Territorial Board of
23 Equalization, 9 Ariz. 383, 398, 84 P. 511,516 (1906).

24 Certificates of contributions are issued in conjunction with payments of a
25 member insurer to the Guaranty Fund based on assessments made by the Fund.
26 A.R.S. §20- 692.

27 In applying a statute, its language must be given effect when there is no
28 ambiguity rather than utilizing other rules of statutory construction. Janson v.
29 Christenson, 167 Ariz. 470, 471, 808 P.2d 1222 (1991). A.R.S. §20-692 is silent as
30 to whether certificates of contribution are transferable. Therefore, one must look at

1 the legislature's intent of the statute. In order to determine the intent, the entire
2 statutory scheme involving the Guaranty Fund must be considered. The Guaranty
3 Fund was created to establish a reservoir of available funds to handle covered claims
4 of policyholders of insurers transacting the business of life and disability insurance in
5 Arizona who become impaired. See A.R.S. §20-683 and §20-685.

6 7 **Certificates of Contribution Relate to Policyholder Obligations or Certificate of Authority**

8 Petitioner argues that certificates of contribution are "tied to policyholder
9 obligations". The Department maintains that the certificates of contribution relate to
10 the certificates of authority and not the underlying policyholder obligations. To an
11 extent, there is merit to Petitioner's argument because the assessments that give rise
12 to certificates of contribution are based on the respective insurer's business. See
13 A.R.S. §20-686. However, it is also true that the purpose of the Guaranty Fund and
14 the assessments made by the Fund is to protect the public and a consequence of
15 conducting the business of life insurance in Arizona.¹

16 The reality is that the certificates of contribution relate to both the policyholder
17 obligations and the certificates of authority. However, because A.R.S. §20-692 (B)
18 provides that certificates of contribution may be used in the future to offset premium
19 taxes, they are not necessarily "tied to" the policyholder obligations that give rise to
20 the certificates in the first instance. Consequently, this Judge determines that the
21 more compelling argument regarding the issuance of certificates of contribution is that
22 they relate to the member insurer's certificate of authority to transact the business of
23 insurance in the State of Arizona.

24 **Transferability Of Certificates Of Contribution**

25 Petitioner claims that the certificates of contribution in issue are freely
26 transferable and admitted assets of PFL, having acquired them from NOLIC and
27 Pacific Fidelity in a tax-free reorganization. The evidence of record establishes that
28 Petitioner consolidated the life and disability insurance businesses of NOLIC and
29 Pacific Fidelity by way of a tax-free reorganization, rather than merger. In proceeding

30 ¹ A.R.S. §20-683 provides that all member insurers shall be members of the Fund as a condition of their authority to transact the business of insurance in the State of Arizona.

1 in this manner, without contacting the Department, Petitioner, on its own, concluded
2 that the certificates of contribution in issue could be transferred and used by Petitioner
3 as premium tax offset credits.

4 Additionally, Petitioner asserts that because the certificates of contribution are
5 reported in Petitioner's Annual Statements as admitted assets, Petitioner can utilize
6 the certificates of contribution as premium tax offset credits. The Department
7 maintains that the certificates of contribution are not transferable, and distinguishes
8 between financial reporting requirements and premium tax determinations.

9 In support of its contention that the certificates of contribution are transferable,
10 Petitioner provides credible evidence that the National Association of Insurance
11 Commissioner ("NAIC") has determined that such certificates are not non-admitted
12 assets, thereby effectively determining that they are admitted assets, and, as such,
13 are transferable. Furthermore, Petitioner relies on A.R.S. §20-501(11) that allows the
14 reporting of assets in an insurer's annual statement as approved by the NAIC.² As
15 additional support for its position, Petitioner presented the testimony of an expert
16 witness, James Tait, who opined that the certificates are admitted assets and
17 transferable.

18 The Department points out that what may be appropriate for financial reporting
19 purposes is not necessarily the same for premium tax considerations. While there is
20 that distinction, it does not make sense to this Judge for the Department to allow an
21 insurance company to treat an item as an admitted asset for financial reporting
22 purposes but not allow the use of that item as a credit for tax consideration purposes.

23 During the hearing, credible evidence established that but for the Arizona
24 statutes allowing certificates of contribution to be used as premium tax offset credits,
25 the certificates of contribution have no value. Therefore, if one considers the
26 certificates of contribution to be assets, they are highly unusual assets and only
27 assets of a limited nature, in that they can only be considered assets for insurers that
28 can use them as premium tax offset credits. As noted above, it appears to be

29 ² A.R.S. §20-501(11) provides: All assets, whether or not consistent with the provisions of this section,
30 as may be allowed pursuant to the annual statement form approved by the national association of
insurance commissioners for the kinds of insurance to be reported upon therein .

1 inconsistent to allow certificates of contribution to be considered assets when their
2 only value is as premium tax credit offsets and then to disallow the offsets.

3 A.R.S. §20-686(H) provides that a “certificate of contribution may be shown by
4 the insurer in its financial statement as an asset in such form and for such amount
5 and period of time as the director may approve.” The Department contends that
6 NOLIC and Pacific Fidelity are the insurers who may list the certificates of contribution
7 in issue as admitted assets in their annual statements, while the Petitioner maintains
8 that it is entitled to list the certificates of contribution as admitted assets in its annual
9 statements. Who can list the certificates of contribution in annual statements is not an
10 issue before this tribunal and is not dispositive of whether certificates of contributions
11 are transferable.

12 Petitioner argues that the certificates of contribution can be listed as admitted
13 assets for its financial reporting and should be able to use them as premium tax credit
14 offsets. However, the language in A.R.S. § 20-692 contemplates the use of certificate
15 of contribution as a premium tax credit offset “*for the member insurer who was issued*
16 *the certificate*”. In the instant case, it is undisputed that NOLIC and Pacific Fidelity
17 and not PFL were issued the certificates of contribution. Therefore, Petitioner’s
18 argument on the above-stated basis fails.

19 Another argument raised by Petitioner regarding the transferability of the
20 certificates of contribution concerns how Petitioner’s domicile state, Iowa, deals with
21 this issue. Iowa allowed the certificates of contribution to be listed as admitted assets
22 in Petitioner’s annual statements. Petitioner argues that precluding Petitioner from
23 reporting the certificates of contribution as assets will affect how Iowa treats Arizona
24 domiciled insurers doing business in Iowa with respect to their reporting under the
25 retaliatory provisions regarding foreign insurers. Further, Petitioner claims that under
26 “comity of law” the Department should treat the certificates of contribution in issue as
27 Petitioner’s assets in deference to the laws of Iowa and other states that provide for
28 such treatment. Regardless of the effect of the Department’s ruling regarding this
29 matter, the issue is whether the Department’s determination regarding the non-
30 transferability of the certificates of contribution and the disallowance of the premium

1 tax credit offsets associated with the certificates was appropriate. It is pure
2 speculation as to how the State of Iowa or other states will react to the Department's
3 determination in this matter and, also, such action is not relevant to this proceeding.

4 To compound the complexity of transferability issue, if, as Petitioner claims, the
5 certificates of contribution are transferable, there is the problem of dealing with partial
6 transfers or fractional transfers. From a regulatory viewpoint, such transfers could be
7 very problematic and are not specifically addressed or necessarily contemplated in
8 this state's insurance statutes. This is further evidence that the State Legislature did
9 not contemplate or intend for the certificates of contribution to be freely transferable.

10 Despite Petitioner's contention that there is no statutory prohibition in the
11 insurance laws for the transferability of certificates of contribution and the assertion
12 that, as assets, they are freely transferable, Petitioner fails to cite express authority
13 providing for their transferability.

14 Although Petitioner cites several cases in its prehearing memorandum
15 regarding the use and transferability of tax credits, in its Response memorandum, the
16 Department distinguished those cases from the instant matter. The particular statutes
17 in question in those cases either stated or, by implication, contemplated transferability
18 while in the instant case no such inference can be made. Therefore, Petitioner does
19 not meet its burden of showing by a preponderance of the evidence that certificates of
20 contribution are transferable.

21 **Department's Policy of Allowing Transferability of Certificates of** 22 **Contribution in Mergers**

23 In further support of Petitioner's argument, credible evidence was presented,
24 and acknowledged by the Department, that the Department has a policy of allowing
25 certificates of contribution to be transferable and utilized as premium tax offset credits
26 by an insurer other than the insurer whose name appears on the certificates when
27 there is a merger.

28 Petitioner claims that the instant tax-free organization is akin to a merger in
29 that, except for the corporate charter, the certificates of authority, and the minimum
30 capital reserve requirements, all assets and liabilities of NOLIC and Pacific Fidelity
were transferred to Petitioner. Petitioner further asserts its right to utilize the

1 certificates of contribution in question because it paid all of the assessments that gave
2 rise to the certificates.

3 The Department distinguishes the instant matter from a merger situation by
4 stating that in mergers there is one surviving entity whereby the company that merges
5 into the surviving entity ceases to exist and no longer maintains its certificate of
6 authority. This Judge is cognizant of the statutory requirements that mergers be
7 subject to approval by the Director of the Department after holding a public hearing.
8 See A.R.S. 20-731. In that regard, mergers are distinguishable from tax-free
9 reorganizations, such as the instant matter, where approval of the transaction by the
10 Department's Director was not sought.

11 The Department maintains that a strict interpretation of A.R.S. §20-692 should
12 be applied, and argues that only the insurer in whose name the assessments are
13 made may utilize the corresponding certificates of contribution. That argument has
14 considerable merit when one looks at the fact that the assessments are limited to not
15 more than 2% of the member insurer's Arizona premiums in the calendar year of the
16 assessment. A.R.S. §20-686(D). The assessments that underlie certificates of
17 contribution are derived from a computation utilizing the particular member insurer
18 that undergoes the assessment. This fact, as well as the determination that
19 certificates of contribution are more closely tied to the certificate of authority of a
20 member insurer to transact business in the State of Arizona, supports the
21 Department's position that the insurance statutory scheme does not contemplate
22 transferability of certificates of contribution.

23 The Department fails to present any authority justifying its policy of allowing
24 certificates of contribution to be transferable in mergers. Nevertheless, even the
25 Petitioner recognizes, in its Memorandum of Law, that the Department is obligated to
26 give effect to the general corporate laws enacted in Arizona unless inconsistent with
27 the provisions of A.R.S., Title 20. See A.R.S. §20-704. Under A.R.S. §10-1106, the
28 surviving entity of a merger stands in the place of the entity it merges with. Therefore,
29 the surviving entity is obligated to the liabilities of the entity within which it has merged
30 and assumes all of its assets. In such a situation, by operation of law, the surviving

1 entity is entitled to the ownership and use of certificates of contribution that were
2 originally issued in the name of the non-surviving entity involved in the merger.
3 Though the Department's allowance of the surviving entity to utilize certificates of
4 contribution under such circumstances has been framed as providing for the
5 "transferability" of certificates of contribution, the Department is merely giving effect to
6 the merger, which it is required to do under A.R.S. §20-704. The tax provision under
7 which the transfers of assets and liabilities occurred in this instance does not mandate
8 the same recognition.

9 The Department also distinguishes the instant matter from a merger in that in
10 this case, the two insurance companies that were assessed and received certificates
11 of contribution, NOLIC and Pacific Fidelity, continue to maintain their certificates of
12 authority and can write new insurance business resulting in premium tax
13 assessments. Given this situation, the Department correctly points out that should
14 either NOLIC or Pacific Fidelity claim the certificates of contribution at issue as
15 premium tax offset credits, the Department would be legally obligated under the
16 relevant statutes to honor the request. In addition, if Petitioner claimed the right to
17 use the same certificates of contribution as premium tax offset credits, the
18 Department would be faced with multiple claims.

19 Although the instant tax-free reorganization seems like a merger, there was no
20 hearing before the Department and approval by the Director of the Department
21 ("Director") was not obtained. The public hearing is a safeguard whereby members of
22 the public, interested persons, and the Department have an opportunity to address
23 concerns and issues before an administrative law judge who issues a recommended
24 decision for the Director to consider. That safeguard for the insurance industry and
25 public would be nonexistent if this Judge determined that the certificates of
26 contribution are freely transferable and that the Petitioner need not obtain the
27 Director's approval.

28 **Estoppel**

29 Petitioner next contends that the equitable principle of estoppel lies against the
30 state by not permitting it to disallow the premium tax offset credits. The essential

1 elements of estoppel consist of conduct by which one induces another to believe
2 certain material facts, resulting in reliance, which causes an injury. Darner Motor
3 Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 682 P.2d 388 (1984).

4 Generally, estoppel will not lie against the state or its agencies in matters
5 affecting its sovereign function. Mohave County v. Mohave-Kingman Estates, Inc.,
6 120 Ariz. 417, 586 P.2d 978 (1978). However, in certain instances, estoppel will be
7 applied against the state when a serious injustice would result if it were not applied
8 provided the public interest is not unduly damaged by its imposition. Freightways v.
9 Arizona Corporation Commission, 129 Ariz. 245, 248, 630 P.2d 541, 544 (1981). See
10 Tucson Electric Power v. Department of Revenue, 174 Ariz. 507, 851 P.2d 132 (App.
11 1992) (where the state was estopped from challenging the taxpayer's compliance with
12 certification requirements of a former statute based on the Department of Revenue's
13 prior representations); See also Valencia Energy Co. v. Department of Revenue, 191
14 Ariz. 565, 959 P.2d 1256 (1998) (In reviewing Valencia's appeal of summary
15 judgment granted in favor of the Department of Revenue, the Arizona Supreme Court
16 held estoppel may lie against the Department of Revenue when it was requiring
17 Valencia to pay taxes on coal shipped to an Arizona electric plant even though prior to
18 the shipments, Valencia received a letter from the Department stating that Valencia
19 would not be subject to taxation. In reliance on the letter, Valencia did not collect the
20 taxes to the clients that received the shipments).

21 Unlike Tucson Electric Power and Valencia, Petitioner considered itself
22 obligated to pay the NOLIC and Pacific Fidelity assessments through the commercial
23 transaction that resulted in the tax-free reorganization. Petitioner also failed to
24 establish detrimental reliance on the Department's audits in which the premium tax
25 credit offsets were not disallowed. Because the first audit by the Department was
26 performed in 1994, Petitioner could not have relied on the audit conducted for the
27 1992 and 1993 calendar years. Although Petitioner claims that by the Department not
28 disallowing the offsets in its initial audits for 1992, it has been substantially injured
29 because it would not have made subsequent assessment payments to the Fund.
30 However, the evidence of record establishes that Petitioner believed it was

1 contractually obligated to pay the liabilities of NOLIC and Pacific Fidelity, which
2 included the assessments for the years in question. Consequently, any injury
3 Petitioner sustained resulting from the Department's delay in disallowing the premium
4 tax credit offsets at issue affects any penalties and interest imposed by the
5 Department but does not relate to the premium taxes owed.

6 This Administrative Law Judge is concerned that the Department had three
7 different revenue auditors over the years in question permit Petitioner to utilize the
8 certificates of contribution as premium tax offset credits. However unfortunate that
9 may be, the evidence of record established that those determinations were mistakes
10 that the Department later corrected by its July 1998 disallowance of the tax offset
11 credits. Therefore, it is determined that estoppel does not lie against the Department
12 in this instance.

13 Laches

14 Petitioner also contends that the equitable doctrine of laches applies, thus
15 precluding the Department from enforcing its decision to disallow the premium tax
16 credit offsets. Laches arises when one does not act diligently, resulting in injury or
17 prejudice to another. Decker v. Hendricks, 97 Ariz. 36, 396 P.2d 609 (1964).
18 However, the passage of time alone does not amount to the requisite prejudice.
19 Cauble v. Osselaer, 150 Ariz. 256, 259,722 P.2d 983 (App. 1986).

20 For the same reasons as set forth above regarding estoppel, Petitioner's
21 argument of laches is not persuasive as to the underlying principal premium tax
22 amount Petitioner owes to the Department, though the activity of using premium tax
23 offsets of other insurers through the use of certificates of contribution was allowed to
24 continue over a six year period. The argument is persuasive with respect to whether
25 any penalties and interest that should be assessed against Petitioner.

26 The actions of the Petitioner are not to be condoned, particularly the fact that it
27 did not inquire as to the Department's position as to the certificates of contribution
28 prior to the effective date of the tax-free reorganization and no such contact occurred
29 until Petitioner received the Department's disallowance of the premium tax offset
30 credits. However, the Department too must bear some responsibility in not notifying

1 Petitioner in a timely manner as to the disallowance of the premium tax credit offsets.

2 The Department relies on Valencia to assert that the imposition of penalties
3 and interest is appropriate, notwithstanding the Department's delay in disallowing the
4 offsets. In Valencia, the Court determined that holding that taxes be paid does not
5 constitute a detriment to the taxpayer, and the imposition of non-punitive interest on
6 taxes due did not constitute detrimental reliance. This matter is distinguishable from
7 Valencia because the Department failed to notify the insurance Industry or the public
8 of its policy of nontransferability of certificates of contribution, even though the
9 Department ultimately acted in accordance with the law and corrected its prior
10 mistakes. It is determined that under the particular facts and circumstances of this
11 matter, it is not appropriate to impose penalties and interest as that would constitute a
12 detriment to Petitioner.

13 **Department's Action Must Be By Rule or**
14 **Substantive Policy Statement**

15 The Petitioner also argues that, in interpreting A.R.S. §20-692 in the manner it
16 has, the Department is following a policy that has not been set forth in a rule or
17 substantive policy statement. See A.R.S. §§41-1001 et seq. Therefore, Petitioner
18 contends that the Department's determination to disallow the transferability of the
19 certificates of contribution and, thus, disallow certain premium tax offset credits should
20 be nullified because the Department's determination is based on an unwritten and
21 unpublished policy that should have been set forth by rule or in a substantive policy
22 statement.

23 The Department maintains that it does not require a rule or substantive policy
24 statement to interpret a statute. It asserts that because there is independent legal
25 authority to support its action, the denial of the transfer of certificates contribution and
26 the disallowance of the premium tax offset credits is not invalid.

27 Under A.R.S. §41-1001(17), a "rule" is defined as "an agency statement of
28 general applicability that implements, interprets or prescribes law or policy, or
29 prescribes the procedure or practice requirements of an agency...".
30

1 A "substantive policy statement" is defined as:

2 a written expression which informs the general public of an
3 agency's current approach to, or opinion of, the requirements of the
4 federal or state constitution, federal or state statute, administrative rule
5 or regulation, or final judgment of a court of competent jurisdiction,
6 including, where appropriate, the agency's current practice, procedure or
7 method of action based upon that approach or opinion.....

8 A.R.S. §20-1001(20).

9 The Department admits that it follows a policy of not allowing certificates of
10 contribution to be transferable, except in mergers. That policy is not set forth in any
11 statute, rule, or writing that is readily available to the insurance industry or public. The
12 Department believes that a rule is not required because it is applying a statute. Yet,
13 that statute is silent on the issue of transferability. However, as noted above, there is
14 legal authority to support the Department's determination that the certificates are not
15 transferable.

16 In this case, even though the Department did not act by rule or substantive
17 policy statement, its determination stands if there is independent authority to support
18 its action. General Motors Corp. v. Arizona Department of Revenue, 189 Ariz. 86,
19 938 P.2d 481 (App.1996).

20 The evidence established that Petitioner took action without regard to the
21 Department's position on this matter and did not attempt to communicate with the
22 Department to learn whether any substantive policy statement, circular letter, or order
23 existed that set forth the Department's policy. As set forth above, the weight of the
24 evidence supports the Department's determination. While Petitioner presented strong
25 arguments in support of its position, the weight of the evidence does not support
26 Petitioner's position. It is determined that Petitioner did not sustain its burden of
27 proving that it is entitled to the premium tax offset credits that were disallowed by the
28 Department for the calendar years 1992 through 1997. Petitioner sustained its
29 burden of proving that interest and penalties should not be assessed against it for
30 non-payment of premium taxes.

Although it is determined that the Department's disallowance of the premium
tax offset credits Petitioner utilized for the years 1972 through 1977 are upheld,

1 nothing herein is intended to preclude Petitioner from pursuing any claim for
2 reimbursement or exercising its legal or equitable rights in an appropriate forum with
3 respect to the funds it paid to the Guaranty Fund that were credited in the name of
4 NOLIC and Pacific Fidelity for assessments for the years 1992 through 1997.

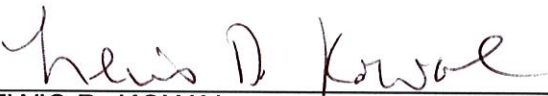
5 **Equal Protection Clause**

6 With respect to Petitioner's claim that the Department's action violates the
7 Equal Protection Clause of the Arizona Constitution, the Administrative Law Judge
8 declines to rule on that constitutional issue as it is more appropriate for a civil court of
9 competent jurisdiction to determine that issue.

10 **RECOMMENDED ORDER**

11 Based on the above, the Administrative Law Judge recommends that the
12 Director of the Department uphold the disallowance of the premium tax offset credits
13 relating to the certificates of contribution issued by the Guaranty Fund to NOLIC and
14 Pacific Fidelity that were utilized by Petitioner for the years 1992 through 1997; that
15 the Department take appropriate measures to advise the insurance industry and the
16 public as to its policy concerning the non-transferability of certificates of contribution;
17 that the Department take appropriate measures so that the certificates of contribution
18 be numbered for ease of record keeping and tracking; and that the premium taxes at
19 issue herein be upheld. Because it is determined that since the Department has
20 discretion in assessing penalties and interest, the Administrative Law Judge
21 recommends that the Director of the Department exercise that discretion favorably
22 towards the Petitioner and not impose penalties or interest in this instance.

23 Done this day, April 20, 1999.

24
25 
26 LEWIS D. KOWAL
27 Administrative Law Judge
28
29
30

1 Original transmitted by mail this
2 21 day of April, 1999, to:

3 Charles R. Cohen, Director
4 Department of Insurance
5 2910 North 44th Street, Ste. 210
6 Phoenix, AZ 85018

7 ATTN: Curvey Burton

8 By Chris Crawford Thomson
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