IT-23-0001-GIL 03/21/2023 BASE INCOME; MODIFICATIONS

Explanation of the Illinois income tax treatment of Medicare Title XVIII premiums and related expenses. (This is a GIL.)

March 21, 2023

NAME
Tax Senior Manager
COMPANY
ADDRESS

Re: Illinois Income Tax – Taxability of Medicare XVIII Premiums

Dear XXX:

This is in response to your email dated December 4, 2022, in which you request information regarding the taxability of Medicare Title XVIII premiums under Illinois law. The nature of your request and the information you have provided require that we respond with a General Information Letter ("GIL"), which is designed to provide general information, is not a statement of Department policy, and is not binding on the Department. See 2 Ill. Adm. Code Section 1200.120(b) and (c), which may be found on the Department's website at www.tax.illinois.gov.

Your letter states as follows:

> I have a client that is an insurance company solely selling Medicare Title XVIII premiums. It is our understanding that under Section 1854(g) of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (attached), these premiums are exempt from state income and premium taxes. The act states: "No state may impose a premium tax or similar tax with respect to payments to Medicare+Choice organizations under section 1853." I am interpreting this language to mean the state cannot impose tax on income generated from these Medicare premiums if they meet the guidelines. However, under federal law these premiums are subject to taxation. I would like to confirm that my client will need to subtract the Medicare premium income that falls under the federal act from its federal taxable income to reach its Illinois taxable income.
>
> Assuming we do subtract this income from our federal taxable income, does Illinois require us to add back any related expenses deducted at the federal level? Since this income is taxable at the federal level, related expenses are deducted to reach our federal taxable income. However, if Illinois does not tax this income, do we need to add back the expenses originally deducted at the federal level? I could not find any Illinois guidance requiring these expenses to be added back but want to confirm. If we do have to add back these expenses, can you please direct me to that guidance for my own reference and review.

> If there is a more appropriate IDOR representative, with whom to review this question, please let me know and I will reach out. Thank you in advance for your time and attention to this question.

RULING

Section 201(a) of the Illinois Income Tax Act ("IITA", 35 ILCS 5/101 et seq.) imposes a tax measured by net income on corporations on the privilege of earning or receiving income in or as a resident of Illinois. In addition, Section 201(c) of the IITA imposes a second tax (the personal property tax replacement income tax) measured by net income on corporations (including Subchapter S corporations), partnerships, and trusts on the privilege of earning or receiving income in or as a resident of Illinois.

For most corporations, the starting point in calculating "net income" for purposes of IITA Section 201 is to first calculate the taxpayer's Illinois base income. IITA Section 203(b)(1) defines "base income" in the case of a corporation as an amount equal to the taxpayer's taxable income, adjusted for certain statutorily prescribed addition and subtraction modifications under IITA Section 203(b)(2). IITA Section 203(e) defines "taxable income" as the amount of taxable income properly reportable for federal income tax purposes for the taxable year under the provisions of the Internal Revenue Code ("IRC"). IITA Section 203(h) states as follows:

> Except as expressly provided by this Section there shall be no modifications or limitations on the amount of income, gain, loss or deduction taken into account in determining gross income, adjusted gross income, or taxable income for federal income tax purposes for the taxable year, or in the amount of such items entering into the computation of base income and net income under this Act for such taxable year, whether in respect of property values as of August 1, 1969 or otherwise.

IITA Section 202 then defines net income as that portion of the taxpayer's "base income" as defined in IITA Section 203, which is allocated or apportioned to Illinois under the provisions of Article 3 of the IITA, less certain deductions. Base income that constitutes nonbusiness income is allocated to Illinois under IITA Sections 301(c)(2) and 303. Base income that constitutes business income is apportioned to Illinois under IITA Section 304.

Although the IITA does not define the term "insurance company," IITA Section 102 states "except as otherwise expressly provided or clearly appearing from the context, any term used in this Act shall have the same meaning as when used in a comparable context in the United States Internal Revenue Code." 86 Ill. Adm. Code Section 100.3420(b) provides the term "insurance company" for Illinois income tax purposes to mean any taxpayer properly treated as an insurance company for federal income tax purposes under Subchapter L of the IRC (Sections 801 through 848).

In general, pursuant to IITA Section 304(b)(1), the business income of an insurance company for a taxable year is to be apportioned to Illinois by multiplying the income by a fraction, the numerator of which is the direct premiums written for insurance upon property or risk in this State, and the denominator of which is the direct premiums written for insurance upon property or risk everywhere. The term "direct premiums written" as defined in IITA Section 304(b)(1) means "the total amount of direct premiums written, assessments and annuity considerations as reported for the taxable year on the annual statement filed by the company with the Illinois Director of Insurance."

86 Ill. Adm. Code Section 100.3420(c)(1) further explains "direct premiums written" as related to the apportionment factor:

> The apportionment factor shall take into account only those receipts that are included in either "gross premiums written" under IRC Section 832(b)(4)(A) or "gross amount of premiums" under IRC Section 803(a)(1)(A). Only receipts that are included in federal taxable income of the taxpayer, and that are not subtracted in the computation of the IITA, may be included in the apportionment factor. (See *Continental Illinois National Bank and Trust Company of Chicago v. Lenckos*, 102 Ill. 2d 210 (1984).)

In addition, 86 Ill. Adm. Code Section 100.3420(c)(2) provides only direct premiums written for insurance, assessments against mutual policyholders and consideration for annuity contracts that include elements of insurance are to be included in the apportionment factor. Other receipts are excluded from the apportionment factor, even if included in net income. Some examples of receipts excluded from the apportionment factor are listed in 86 Ill. Adm. Code 100.3420(c)(3): interest, dividends and other income from investments; gains or losses from the adjustment of reserves, salvage or subrogation; deposit-type funds; premiums on which State income taxes are prohibited by federal law.

86 Ill. Adm. Code Section 100.3420(d) provides:

> (d) Insurance on Property or Risk in this State. A direct premium is written for insurance upon property or risk in this State and included in the numerator of the apportionment factor if it is allocated to this State in the annual statement filed by the insurance company with the Director of Insurance. If an insurance company does not file an annual statement with the Director of Insurance or if any direct premiums written by an insurance company are not allocated to a specific state on its annual statement, that insurance company shall include in the numerator of its apportionment factor the direct premiums written for insurance on property or risk in this State, determined in accordance with the determination of gross taxable premium written under Section 409(1) of the Illinois Insurance Code [215 ILCS 5/409(1)], provided that the determination shall be made without allowing

> the exceptions in that Section 409(1) for premiums on annuities, premiums on which State premium taxes are prohibited by federal law, premiums paid by the State for Medicaid eligible insureds, premiums paid for health care services included as an element of tuition charges at any university or college owned and operated by the State of Illinois, premiums on group insurance contracts under the State Employees Group Insurance Act of 1971 [5 ILCS 375], or premiums for deferred compensation plans for employees of the State, units of local government or school districts.

Section 409(1) of the Illinois Insurance Code provides for the annual privilege tax payable by insurance companies that write certain types of insurance. This state privilege tax is equal to a percentage of the net taxable premium written, together with any amounts due under Section 444 of the Illinois Insurance Code. The gross taxable premium written is the gross amount of premiums received on direct business during the calendar year on contracts covering risks in Illinois but exempts a statutory list of premiums including those premiums on which State premium taxes are prohibited by federal law.

42 U.S.C. § 1395w-24 (Section 1854(g) of Title XVIII of the Social Security Act) "Prohibition of State Imposition of Premium Taxes" provides:

> No State may impose a premium tax or similar tax with respect to payments to Medicare+Choice [Medicare Advantage; "MA"] organizations under section 1853 [42 U.S.C. § 1395w-23].

42 U.S.C. § 1395w-26(b)(3) (Section 1856(b)(3) of Title XVIII of the Social Security Act) "Relation to State laws" provides:

> The standards established under this part [42 U.S.C. § 1395w-21 et seq.] shall supersede any State law or regulation (other than State licensing laws or State laws relating to plan solvency) with respect to MA plans which are offered by MA organizations under this part.

42 C.F.R. § 422.404 "State premium taxes prohibited" provides:

> (a) Basic rule. No premium tax, fee, or other similar assessment may be imposed by any State, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, and American Samoa, or any of their political subdivisions or other governmental authorities with respect to any payment CMS makes on behalf of MA enrollees under subpart G of this part, or with respect to any payment made to MA plans by beneficiaries, or payment to MA plans by a third party on a beneficiary's behalf.

> (b) Construction. Nothing in this section shall be construed to exempt any MA organization from taxes, fees, or other monetary assessments related to the net income or profit that accrues to, or is realized by, the organization from business conducted under this part, if that tax, fee, or payment is applicable to a broad range of business activity.

Therefore, as outlined above, the computation of Illinois privilege tax aligns with federal law by exempting payments to Medicare+Choice [MA] organizations in the privilege tax calculation. Illinois income tax, however, is a tax on net income. It is not a "premium tax or similar tax" as applied to Medicare+Choice [MA] organizations because it is not imposed on direct premiums and applies to a broad range of business activities of the taxpayer [cf. *Health Net Life Ins. Co. v. Dep't of Revenue*, 24 OTR 514, Or. T.C. May 3, 2021, holding Oregon's minimum tax is not a tax "on" net income as it is a "premium tax or similar tax"; *Group Health Cooperative v. Department of Revenue*, 8 Wash App 2d 210, 438 P3d 158 (2019) holding that Washington business and occupation tax was "similar" to a premium tax]. An insurance company selling Medicare Title XVIII premiums in Illinois is not exempt from Illinois income tax and may not subtract that premium income when computing base income.

In general, income and expenses should be aligned. As the Medicare Title XVIII premiums are included in base income, the related expenses should be allowed as a deduction. However, no provision in IITA Section 203 requires the related expenses to be added back to federal taxable income. Therefore, pursuant to IITA Section 203(h), no modification to federal taxable income is allowable.

As stated above, this is a GIL. A GIL does not constitute a statement of Department policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department.

Sincerely,

Jennifer Uhles
Associate Counsel (Income Tax)