SOUTH CAROLINA
Insurance LAW BLOG
Collins Lacy ATTORNEYS AT LAW
CHARLESTON COLUMBIA GREENVILLE MYRTLE BEACH www.collinsandlacy.com

Municipal Tax on Flood Insurance Premiums Barred by Doctrine of Sovereign Immunity

Logan Wells, Attorney
Direct Line: 864.282.9108
lwells@collinsandlacy.com

Practice Areas:
- Insurance Coverage
- Professional Liability

South Carolina municipalities are not entitled to assess municipal business license taxes based on, or measured by, the total flood insurance premiums collected in the particular municipality by insurance companies under an arrangement with FEMA, according to a March 1, 2013 opinion of the Fourth Circuit Court of Appeals. Finding the taxes contravened the principles of sovereign immunity, the Fourth Circuit reversed a decision of the U.S. District Court for the District of South Carolina.

In Municipal Association of South Carolina (MASC) v. USAA General Indemnity Company, the MASC sought a declaration that South Carolina municipalities are entitled to tax insurers that sell insurance policies in South Carolina and collect premiums on Standard Flood Insurance Policies ("SFIPs") pursuant to the National Flood Insurance Program ("NFIP").[1] The insurers moved for summary judgment on the basis of, inter alia, sovereign immunity. The district court denied the insurers' motion and certified the matter for interlocutory appeal.

On appeal, the insurers argued that in their operation of the Write-Your-Own ("WYO") Program[2] under the NFIP, the insurers were "fiscal agents" of the federal government, and the municipal tax was an impermissible, unconsented-to tax on the Government and its property, in violation of sovereign immunity. Recognizing that, pursuant to the Supremacy Clause of the U.S. Constitution, the federal government has absolute immunity from state regulation, including taxation of the Government itself, its property, or on an agency or instrumentality closely connected to the Government, the court addressed the following questions – whether: (1) the flood insurance premiums collected by WYO Companies are federal property; (2) WYO Companies, in their participation in and operation of the WYO Program, are instrumentalities of the Government; and (3) the Government has consented to the municipal tax.

Federal Property: The Fourth Circuit has previously recognized that premiums collected on policies written by WYO Companies do not belong to those companies, but instead, belong to the federal government, and may not be taxed without consent. Nonetheless, MASC argued the premiums passed through the WYO Companies and were not federal funds until they reached the U.S. Treasury. The court rejected this argument, noting: (1) the NFIA stated that the premiums collected under Part B by facilities of the federal government are credits to the National Flood Insurance Fund; (2) the FEMA regulations for the WYO Program referred to the premiums as "federal funds;" and (3) a 2008 FEMA memorandum interpreting the FEMA regulations stated "the premiums collected as payment for coverage under the [SFIPs] are Federal dollars." Thus, the court found the premiums were federal property.

Government Instrumentalities: A taxed entity is closely connected to the federal government if taxation of the entity would be a direct interference with the functions of government itself. To resist a State's taxing power, a private taxpayer must stand in the Government's shoes. Under Part B of the NFIA, FEMA is required to carry out the NFIP "through the facilities of the Federal Government" utilizing either federal employees or insurance companies "as fiscal agents of the United States." As the U.S. Code does not define "fiscal agent," the court turned to the dictionary definition – "A bank or other financial institution that collects and disburses money and services as a depository of private and public funds on another's behalf" – and reasoned that, in using the term "fiscal agent," Congress contemplated a close relationship between the Government and WYO Companies. Correspondingly, citing Studio Frames, Ltd. v. Standard Fire Insurance Company, 483 F.3d 239 (4th Cir. 2007), the court noted the Fourth Circuit had previously addressed the close connection between WYO Companies and the federal government: "[A] suit against a WYO company is essentially a suit against FEMA. Likewise, a money judgment against a WYO company is essentially a judgment against the Government." Accordingly, the court concluded that in collecting premiums, the WYO Companies were so closely connected to the federal government that a tax on a WYO Company based on the premiums collected was a tax on the Government.

Consent: To be effective, waivers of the Government's sovereign immunity must be unequivocally expressed or consistent with Congress' clear intent to waive sovereign immunity. Finding no provision of the NFIA or FEMA regulations resulted in an effective waiver, the court noted that FEMA has waived sovereign immunity as to "State premium taxes" but no "other taxes." 44 C.F.R. pt. 62 app. A, art. III(A). Municipal taxes are not State premium taxes, however, and therefore, the court concluded, are not within the waiver of immunity. MASC countered by arguing the premiums were merely a measure for determining how much license taxes should be imposed. The court rejected this argument, noting the tax could not be imposed if the WYO Companies failed to collect flood insurance premiums, and further, regardless of the delineation of the tax, the Government had not consented to it. Accordingly, the court found that because the tax was levied on the federal government's property and its instrumentality, without consent, the tax was impermissible.

---

[1] The NFIP was created by the National Flood Insurance Act of 1968 ("NFIA") in part to make federally subsidized flood insurance available in flood-prone areas. Since 1978 the NFIP has been implemented under Part B of the NFIA as a federally operated program with private insurers' assistance. See 42 U.S.C. § 4071(a).
[2] The WYO Program enables FEMA to use participating private insurance companies ("WYO Companies") to provide, under their own names as insurers, SFIPs to the public. The Municipal Association of South Carolina insurers were WYO Companies.

About Logan Wells

Logan Wells is an associate practicing in the areas of insurance coverage and professional liability. She also writes about insurance coverage issues and trends in the South Carolina Insurance Law Blog. She received her undergraduate degree in history and political science from Furman University and earned her juris doctor from the University of South Carolina School of Law. During her undergraduate career, she worked for a law firm in Spartanburg as a legal assistant. While in law school, she worked as a summer associate for Collins & Lacy, before joining the firm as an attorney in the fall of 2009.

About Collins & Lacy, P.C.

Collins & Lacy is a defense litigation firm in South Carolina that delivers valuable legal representation for our clients through solid preparation, thorough execution, and client-oriented service aimed at success. With offices in Charleston, Columbia, Greenville and Myrtle Beach, the firm represents local, regional and national clients in the areas of:

- construction
- employment law
- hospitality/retail & entertainment law
- insurance/bad faith
- products liability
- professional liability
- commercial transportation
- workers' compensation

Collins & Lacy is committed to upholding the highest standards for integrity, civility and community service. For more information, visit www.collinsandlacy.com.