

# Adding Accuracy to Premium Tax Assignments

On-demand access to the most up-to-date location intelligence provides for cost-effective compliance

WHITEPAPER:

**GEOTAX**

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2

### ABSTRACT

U.S. INSURANCE IS BIG BUSINESS, WITH PREMIUM REVENUES EXCEEDING \$1.1 TRILLION.

NOT SURPRISINGLY, STATE AND LOCAL GOVERNMENTS COUNT ON PREMIUM TAXES AS A SIGNIFICANT SOURCE OF REVENUE. IN 2008, U.S. INSURERS PAID MORE THAN \$15.8 BILLION IN STATE PREMIUM TAXES, REPRESENTING 2.6% OF ALL BUSINESS TAX COLLECTED.<sup>1</sup>

TO COMPLICATE MATTERS, PREMIUM TAX ASSIGNMENTS AND REGULATIONS VARY FROM STATE TO STATE. A GROWING NUMBER OF STATES ALLOW LOCAL GOVERNMENTS TO APPLY A SEPARATE "LOCAL GOVERNMENT PREMIUM TAX" TO HELP FINANCE GOVERNMENT SERVICES—AND BORDERS BETWEEN JURISDICTIONS CAN CHANGE RAPIDLY. SOME STATES EVEN HAVE LAWS ON THE BOOKS THAT DETAIL THE SPECIFIC TECHNOLOGIES AND DATA INSURERS MUST ADOPT. CLEARLY, INSURERS NEED TO OVERCOME SIGNIFICANT CHALLENGES IF THEY ARE TO AVOID PAYING AN INCORRECT AMOUNT, WHICH COULD LEAD TO COSTLY OVERPAYMENTS, CLASS ACTION LAWSUITS, PENALTIES AND REGULATORY NON-COMPLIANCE.

INSURERS THAT ONCE RELIED ON MANUAL RESEARCH OR INEFFECTIVE ZIP CODE™ LOOK-UPS HAVE FOUND THAT ACCURATE, COST-EFFICIENT TAX JURISDICTION ASSIGNMENT IS NOW IN REACH. MARKET LEADERS HAVE ADOPTED BEST PRACTICES THAT MAKE IT EASIER TO TAKE ADVANTAGE OF UP-TO-DATE DATA AND PRECISE ASSIGNMENTS WHENEVER AND WHEREVER NEEDED. THESE ON-DEMAND CAPABILITIES PROVIDE A MORE ECONOMIC APPROACH TO MUCH-NEEDED ACCURACY—AND HELP ENSURE THAT THE PROPER TAXES ARE COLLECTED IN EACH AND EVERY MARKET.

# FOR INDIVIDUALS RESPONSIBLE FOR ESTABLISHING TERRITORIES AND EVALUATING PREMIUM TAX RATES, THE RESULT OF THESE INCONSISTENCIES IS EYE-OPENING: BETWEEN 6% AND 25% OF ALL TERRITORY ASSIGNMENTS ARE INCORRECT.

## The Challenge

Premium tax jurisdictions are established by a number of states and local municipalities. In many cases, they are complex and rapidly changing. These complexities and inconsistencies in the assignment of tax jurisdictions not only challenge the ability of an insurance company to accurately assess the correct tax, they also fuel errors resulting in overpayment and underpayment of taxes.

## The Problem with Zip Codes

Typically, most insurance companies use ZIP Codes™ to assign applicable tax jurisdictions. However, most state and local premium tax assignments throughout the U.S. are based on specially defined boundaries that don't necessarily match municipal or ZIP Code™ boundaries.

The primary problem stems from the fact that ZIP Codes™ were created solely for the convenience of expediting mail delivery, not as a foundation for establishing insurance territories or premium taxes. And while ZIP Codes™ may account somewhat for population, they ignore the key demographic and physiographic information that is critical to proper premium pricing.

As a result, ZIP Codes™ don't always correspond to the physical addresses necessary for accurate territory assignments. Boundaries shift frequently (see Figure 1a and 1b), and of the 40 million U.S. ZIP+4 Codes™, 600,000 experience changes in names and boundaries each month.

FIGURE 1: EXAMPLE OF ZIP CODE™ CHANGES

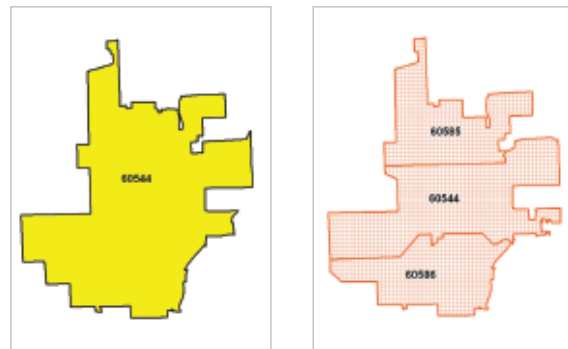


Figure 1a: ZIP Code 60544

Figure 1b: ZIP Code 60544 splits into 3 ZIP Codes

*Note that the three new ZIP Codes do not align evenly with the original ZIP Code boundary. Portions of neighboring ZIP Codes have either been included or removed from the area that constituted what used to be ZIP Code 60544.*

## The Complexity of State and Local Government Assignments

Further complicating the landscape, some states require that insurance premium districts correspond to political or census boundaries, which ebb and flow along with local populations. They may even be based on police or fire districts (as in states like Florida) resulting in still more territory assignment errors.

Of the 20,000 municipalities across the U.S., approximately 30% of ZIP Codes™ are in conflict with municipal, county and even state boundaries,<sup>2</sup> resulting in improper taxes being charged where, in fact, none are due (see Figure 2). They also often lag behind new housing development, failing to include, for example, entirely new sub-divisions.

For individuals responsible for establishing territories and evaluating premium tax rates, the result of these inconsistencies is eye-opening: from 6% to over 25% of all territory assignments are incorrect.<sup>3</sup>

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4

Quite simply, the current system is neither accurate nor efficient and insurance companies are paying the price through pervasive errors that negatively impact tax determination and increase the potential for state compliance problems. They are costly for insurance companies, and not just because insurance companies are often overpaying taxes—premium tax assignments are also igniting expensive litigation and causing severe damage to relationships with customers.

In a class-action lawsuit in Kentucky, for example, plaintiffs claim 13 companies wrongly charged insurance premium taxes based on incorrect tax jurisdiction assignments. In citing municipal tax overcharges by the insurance companies, the complaint alleges, “it is imperative that the Defendants identify the specific county, city, or place in which the risk is located if Defendant is going to assess a local government premium tax to its customers... practices of charging customers for taxes and collection fees that are not owed violate the laws of the Commonwealth of Kentucky.”<sup>4</sup>

Today, thirteen states regulate premium taxes, including Alabama, Arizona, Delaware, Florida, Georgia, Illinois, Kentucky, Louisiana, Minnesota, New Jersey, New York, North Dakota and South Carolina. Some, like Kentucky, require that insurance carriers use a verified geo-spatial database that appends the correct state, county, township municipality and premium tax district information to each customer record. Others, like Florida, dictate specific electronic databases for jurisdiction assignment.

Leading insurance companies, technology providers and state and local governments are now working together to realize fair and equitable premium tax solutions that benefit all parties—including taxpayers and policyholders. On the civic side, new laws now mandate due diligence and higher standards for tax assignments. Increasingly, insurers are adopting new methodologies for assigning correct tax jurisdictions using accurate address information—and are finding new ways to gain insights about location.

### The case for Location Intelligence

As more than 70% of all business records contain a location component, many organizations already have experience with technologies that can correct the inaccuracies and inefficiencies associated with error-prone, ZIP Code-based boundaries. Today’s leading-edge Geographical Information Systems (GIS), for example, combine **geocoding**, the science of assigning latitude and longitude to address locations, and **spatial analysis**, the ability to assess the relationship between two or more points. Such tools are being used today in such far-ranging activities as census gathering, disaster preparedness, fire services, health services, sanitation, transportation, economic development, housing, land use and assessments.

In the insurance industry, location intelligence supports territory assignment, automated underwriting, risk management and claims processing. Given the new laws and regulations in play, many are using similar technologies to more accurately assign premium tax jurisdictions.

Geocoding and spatial analysis both play an integral role in these solutions. Matching physical address information to longitude and latitude coordinates provides insurance companies with an exact location.

User Input:	Standardized Output:
4383 Apple	4383 Apple Ct
Boulder CO 80303	Boulder CO 80301-1745
	-105.248599, 40.054337
	Territory 435

*Note: The returned longitude and latitude coordinates and the assigned territory are shown for illustration purposes.*

When the correct latitude and longitude has been obtained, “spatial analysis” is performed on this coordinate information to determine territory information and proximity to the correct premium tax jurisdiction. Figure 2 illustrates how the Spatial Analysis occurs using multiple types of geographic risks.

OF THE 20,000 MUNICIPALITIES ACROSS THE U.S., APPROXIMATELY 30% OF ZIP CODES ARE IN CONFLICT WITH MUNICIPAL, COUNTY AND EVEN STATE BOUNDARIES, RESULTING IN IMPROPER TAXES BEING CHARGED, WHERE, IN FACT, NON ARE DUE.

### Best Practices in Premium Tax Assignment

The ability to accurately assign premium tax jurisdictions is more critical now than ever before—and insurance companies that fall short risk overpaying, customer dissatisfaction, fines, penalties and regulatory non-compliance. As such, organizations need to consider several factors when assessing alternative solutions. Seven best practices stand out:

#### Tax-Specific Applications

Many companies offer geocoding and spatial analysis tools. There are only a few, however, that offer a suite of products that can address the unique requirements of insurance companies and state and local governments. Given the complexities involved in tax jurisdiction assignment, look for solutions specifically designed for this application. Such solutions, for example, provide more accurate methods to match an address and determine whether it is part of a special tax district, which may involve school districts, fire districts and a variety of other special tax districts including transit, hospital and stadium.

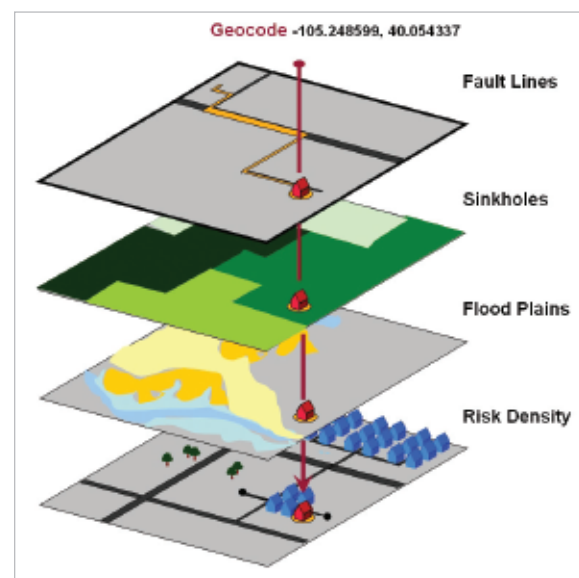
#### Validated Addresses

To get an accurate geocode, you first need an accurate address. Insurers should only consider solutions that start with the correction and standardization of address records. Such tools determine if the address is complete according to official standards and adds a ZIP+4 Code to addresses. Consequently, the accuracy of the resulting geocode and the jurisdiction that is derived from it are optimized.

#### Street-level Geocoding

Some tools return geocodes that simply represent the center point of a ZIP Code™. Leading solutions geocode at the street- or parcel-level, providing the precision needed for accurate jurisdiction assignment. Most geocoding engines use only one reference file to match the input address, but best-in-class solutions will merge multiple data sets, such as USPS addresses and geographic street network data. Through this practice of “conflating” data, geocoding can locate valid addresses that are not in the USPS database.

FIGURE 2: SPATIAL ANALYSIS ON MULTIPLE LAYERS OF GEOGRAPHY



#### Most Current Municipal Boundaries

Access to the most current and accurate information regarding municipal tax boundaries is critical to success. The Tele Atlas’s Dynamap/Municipal Boundaries database (exclusive to Pitney Bowes Business Insight), for example, provides the most up-to-date information on the legal boundaries of incorporated places, with updates on governmental boundary changes from new incorporations, annexations, de-annexations, mergers, consolidations, or dissolution of corporations or local governmental entities.

Local tax geography does not solely encompass municipalities, but also includes premium tax districts. These tax districts are not monitored by the U.S. census or any governmental body. If accuracy is important to your organization, look for a technology provider with an ability to create and maintain these premium tax district boundaries, ideally with updates on a monthly basis.

## Adding Accuracy to Premium Tax Assignments

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6

### Flexible Delivery

Best-in-class technologies are designed around your needs. That means solutions should support batch, client/server and interactive and Web-enabled versions. A critical aspect of this technology is to allow companies to perform spatial analysis “on-the-fly” rather than on an infrequent schedule, enabling these decisions to be made and updated in real-time.

### On Demand/SaaS

Software-as-a-Service, sometimes referred to as On Demand, offers speed, flexibility and scalability. Under this model, a provider hosts, manages and maintains applications and associated data on behalf of its clients, who access the software remotely via the Internet. Increasingly, insurance companies are selecting technology providers who can support this approach, and for good reason:

- **Data complexity.** Leading GIS tools can process enormous amounts of complex data from multiple sources. The unlimited computing power of on-demand solutions provide for much needed speed and capacity.
- **Cost efficiency.** With no capital investments in hardware or long-term software licensing agreements required, accurate tax jurisdiction assignment becomes financial viable for every-sized company.
- **Unlimited users.** With SaaS, GIS applications can be made available to anyone, anytime. As an added bonus, there’s no need to support constant updates, backups and versions—all of which create savings.
- **Speed of innovation.** Obsolete hardware is expensive to replace; disk-based software updates are burdensome to compile, distribute and install. SaaS users, on the other hand, benefit from an ongoing stream of enhancements and upgrades.

### Industry Experience

Lastly, organizations should consider the expertise that technology partners have in your industry. Pitney Bowes

Business Insight, for example, has delivered leading-edge mailing applications, address management and geocoding software to the world’s leading insurance companies for over 25 years. Our technologies make it easy for companies in life, health and property and casualty insurance to cleanse and enrich their data, generate personalized customer communications and integrate and deliver data across the enterprise.

### KENTUCKY VERIFICATION

As of January 1, 2010, the State of Kentucky now requires that insurance carriers use a verified geo-spatial database that appends the correct state, county, township, municipality and premium tax district information to each customer record.

GeoTAX™ Enterprise Tax Management solution from Pitney Bowes Business Insight has been evaluated by the Kentucky Department of Insurance. This solution has been selected and verified based on its accuracy in defining the local tax jurisdictions.

### FLORIDA LIABILITY

Also effective January 1, 2010, the State of Florida has created a database that insurers may use in assigning premiums and policies to the various participating local taxing jurisdictions. Companies using solutions that rely on this data – including the Pitney Bowes GeoTAX™ offering—shall be held harmless from any liability, including but not limited to liability for taxes, interest or penalties that would otherwise be due as a result of an assignment of premiums to an incorrect local taxing jurisdiction.

IN ADDITION TO PRECISE PREMIUM TAX JURISDICTION ASSIGNMENTS, INSURANCE CARRIERS CAN USE THIS TECHNOLOGY, WHICH INCLUDES ADDRESS STANDARDIZATION, TO IMPROVE CUSTOMER RETENTION, REDUCE COSTS AND STREAMLINE OPERATIONS IN ALL STATES THAT HAVE PREMIUM TAXES.

**Assign the most current, most accurate tax jurisdictions with GeoTAX™**

Location Intelligent technologies offer insurers and state and local governments significant and measurable alternatives of premium tax assignments versus manual determination, ZIP Codes™ and generic geocoding tools. The right solution can also improve customer retention, save money and streamline operations.

GeoTAX™ Enterprise Tax Management from Pitney Bowes Business Insight is a comprehensive solution designed specifically for tax applications. This solution standardizes addresses and appends state, county, municipal place and premium tax jurisdiction information to customer address records. It also provides access to the most currently available taxation boundary information through a data update process that continually tracks and updates taxation boundaries nationwide.

Working closely with insurance companies, best-of breed data providers and mapping companies for over 25 years, Pitney Bowes Business Insight offers superior address standardization and geocoding. With more than 600,000 hours of R&D invested in geocoding, Pitney Bowes solutions produce algorithms and geocoding methodologies that are unique to the marketplace—generating true customer intelligence. Always on the leading edge, Pitney Bowes also offers GeoTAX™ as an on-demand application.

Find out how you can get a more accurate view of your customers, and integrate that intelligence into your daily business operations to increase revenue, improve profitability and enhance operational efficiency. To learn more about GeoTAX™ and other best practices in tax jurisdiction assignment, call 800.327.8627 or visit [www.pbinsight.com](http://www.pbinsight.com)

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