TAX-EXEMPT ORGANIZATION INSURANCE PREMIUM TAX DEDUCTION

EVALUATION SUMMARY

APRIL 2019
2019-TE13

THIS EVALUATION WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2019

YEAR ENACTED	1969
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	$3.8 million (TAX YEAR 2018)
NUMBER OF TAXPAYERS	15
AVERAGE TAXPAYER BENEFIT	$254,000
IS IT MEETING ITS PURPOSE?	Yes, but the extent of its impact is unclear

WHAT DOES THIS TAX EXPENDITURE DO?

The Tax-Exempt Organization Insurance Premium Tax Deduction (Tax-Exempt Organization Deduction) allows insurers to deduct from their premium tax any premiums collected for policies purchased by tax-exempt organizations for their employees.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state a purpose for the Tax-Exempt Organization Deduction. We inferred that it was created to lower tax-exempt employers' costs to provide insurance to their employees.

WHAT DID THE EVALUATION FIND?

We determined that the Tax-Exempt Organization Deduction may lower the insurance costs of tax-exempt organizations, but we could not determine the extent of its impact.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The Division of Insurance's filing system and instructions do not clearly indicate how insurers should deduct insurance premiums for insurance purchased by non-profit, charitable, and religious organizations.

TAX-EXEMPT ORGANIZATION INSURANCE PREMIUM TAX DEDUCTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

Colorado levies a 2 percent premium tax on insurance companies' in-state premiums, which is the revenue they collect for writing insurance policies covering property or risks in the state. In 1969, the General Assembly created the Tax-Exempt Organization Insurance Premium Tax Deduction (Tax-Exempt Organization Deduction) [Section 10-3-209(1)(d)(IV), C.R.S.], which allows insurers to deduct from their taxable premiums any premiums they collect on insurance policies or contracts, such as life, accident, disability, and health insurance, that tax-exempt employers purchase for their employees. For the premiums to qualify for the deduction, the employer purchasing the policy or contract must be the State, a political subdivision of the State, or exempt from state income tax under Section 39-22-112, C.R.S., which applies to employers that are exempt from federal income tax, such as charitable, religious, and other non-profit organizations.

To claim the deduction, insurers enter the amount of premiums that qualify on their premium tax return which they submit to the Division of Insurance within the Department of Regulatory Agencies. Insurers deduct this amount from their taxable premium amount before calculating their premium tax. Life insurers, which use a different premium return form than other insurers, enter the amount they are claiming under the Tax-Exempt Organization Deduction on a worksheet that includes a specific line to report the deduction. Non-life insurers do not have a specific line on their premium tax returns for the deduction, and instead would enter the amount they are claiming on a

line for "Other Deductions," which aggregates the amount claimed for several deductions.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of the Tax-Exempt Organization Deduction. Based on the statute and legislative history, we inferred that the direct beneficiaries of this deduction are insurance companies doing business in Colorado who write life, annuity, accident, disability, health, or other types of insurance that the State, political subdivisions of the State, and other tax-exempt organizations purchase for their employees.

However, since the cost of insurance premium tax may be passed on to policyholders, reductions in premium tax may result in reduced prices for policyholders. As a result, tax-exempt employers who purchase insurance for their employees and the employees (and family members if included in the policies) who receive these benefits appear to be the indirect beneficiaries of the deduction. In addition, employer-sponsored insurance typically lowers the price of premiums for each employee relative to what they would pay as individuals and may allow insurance coverage for employees who would be unable to obtain insurance as individuals due to having higher risk factors.

Although the Tax-Exempt Organization Deduction applies to the insurance purchased by all tax-exempt organizations for their employees, many larger public sector employers, such as the State and local governments, provide a significant amount of their insurance coverage, in particular health insurance, to employees by self-insuring (the State is self-insured for some, but not all of the insurance benefits it provides its employees). Employers who self-insure pay some or all of employees' claims from their own funds, although they often still contract with an insurer to act as a "third-party administrator." Self-insurance is not classified as an insurance product in Colorado and is exempt from the State's premium tax, regardless of the Tax Exempt

Organization Deduction. According to a 2018 survey by the Henry J. Kaiser Family Foundation, as of 2018, 72 percent of state and local government employees in the U.S. covered by an employer-sponsored health plan were covered through a self-funded plan. However, for other types of insurance, such as life insurance, many of these employers purchase insurance that would qualify for the deduction.

Similarly, smaller public sector organizations that might not have the resources required to self-insure on their own, often join together to self-insure as a group, in what is known as a "risk pool." Insurance provided through these public sector risk pools is also not subject to insurance premium tax, regardless of the Tax Exempt Organization Deduction. According to the Association of Governmental Risk Pools, about 80 percent of cities, towns, schools, counties, and special districts in the U.S. address some or all of their insurance needs through nonprofit, member-owned risk pooling.

Although many public-sector employers are less reliant on insurance that would be included within the Tax Exempt Organization Deduction, other tax-exempt organizations, such as private non-profits and religious organizations frequently purchase insurance for their employees that would be included. According to the Colorado Nonprofit Association's *2018 Salary & Benefits Survey*, 72 percent of surveyed nonprofit employers offer health insurance, 58 percent offer dental insurance, 45 percent offer disability insurance, and 38 percent offer group life insurance to full-time employees. However, smaller non-profit and religious organizations likely receive a relatively greater benefit from the deduction than larger organizations. According to Colorado Nonprofit Association staff, it is usually only larger Colorado nonprofits with 50 or more employees who self-insure. Self-insurance requires large financial reserves that many smaller employers do not have.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for the Tax-Exempt Organization Deduction. Based on statute, legislative history, and other states' tax expenditure evaluations, we inferred that the deduction was created to lower the cost of insurance that tax-exempt employers provide to their employees. Although the deduction is claimed directly by insurers, it was likely intended to reduce the cost of the insurance employers purchase for employees, based on the expectation that insurance companies would pass the savings from the deduction on to eligible employers.

This purpose aligns with other legislation the General Assembly passed at the same time, which also appears intended to expand access to insurance. Specifically, in 1969, the same year the General Assembly created the Tax-Exempt Organization Deduction, it passed 16 bills related to expanding access to insurance benefits for employees of tax-exempt organizations.

IS THE TAX EXPENDITURE MEETING ITS PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We found that the Tax-Exempt Organization Deduction is likely meeting its purpose, although we could not determine the extent to which it lowers insurance costs for tax exempt organizations. Statute does not provide quantifiable performance measures for this tax expenditure. Therefore, we created and applied the following performance measure to determine the extent to which the deduction is meeting its purpose:

PERFORMANCE MEASURE: *To what extent does the Tax-Exempt Organization Deduction reduce the cost of insurance that the State, political subdivisions of the State, and other tax-exempt organizations purchase for employees?*

RESULT: Insurers claimed the Tax Exempt Organization Deduction for about $200 million in premiums collected from tax exempt organizations in Tax Year 2018 and, as a result, they may provide insurance to tax-exempt organizations at a lower cost. Specifically, based on the 2 percent premium tax and applicable rate reductions that the insurers who took the deduction also claimed, we estimate that the deduction lowered insurers' premium taxes by about $3.8 million in Tax Year 2018. Insurance industry staff we interviewed, which included staff from two of the three companies that claimed the deduction most frequently, indicated that generally, the tax savings from the deduction allow insurers to offer lower premium prices for tax-exempt organizations and indicated that it is often a factor they consider when preparing competitive bids for these organizations. However, we lacked information, such as how insurers calculate premium rates for tax-exempt organizations and the impact the deduction has on those rates, to quantify the impact of the deduction on the cost of insurance.

In addition, we found that insurers likely apply the Tax-Exempt Organization Deduction to a smaller proportion of the insurance they provide than when it was established in 1969, due to the Annuities Exemption [Section 10-3-209(1)(d)(IV), C.R.S.], which the General Assembly created in 1977. A significant proportion of premiums eligible for the deduction during the first decade it was available may have been group annuity policies, which public sector employers commonly purchased in order to provide pension benefits for employees. However, the Annuity Exemption exempts all annuity premiums from insurance premium tax, including public sector employers' group annuities. Therefore, these premiums are exempt from premium tax regardless of the Tax-Exempt Organization Deduction.

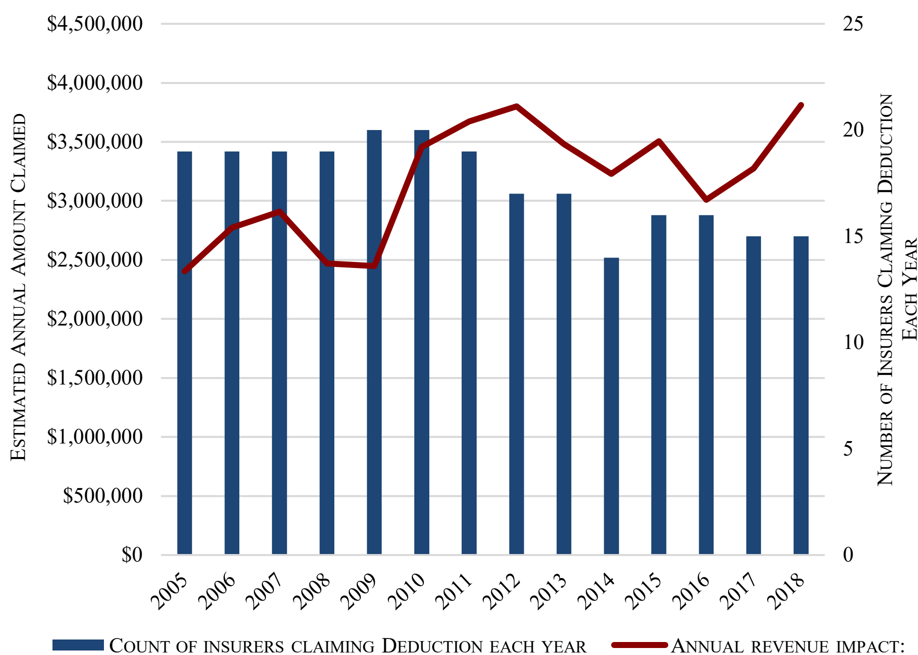
WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURE?

We estimate that the Tax-Exempt Organization Deduction had a revenue impact to the State of about $3.8 million in Tax Year 2018, which is equivalent to how much the 15 insurers who took the

deduction saved, or an average of $254,000 per insurer. We calculated this estimate using data provided by the Division of Insurance from the premium tax returns of "life insurers," a category of insurers that write life, health, and accident insurance. According to Division of Insurance staff, these "life insurers" are the most likely type of insurance companies to claim the deduction. Division of Insurance staff reported that although it is possible that other types of insurers, such as property/casualty insurers or certain types of health insurers that are not considered life insurers, could have also claimed the deduction, it is not likely. However, since the premium tax returns for these other types of insurers do not have a separate reporting line for the deduction, we could not determine the extent to which these insurers also claimed it.

EXHIBIT 1.1 shows the number of life insurers that claimed the deduction from Tax Years 2005 to 2018, as well as its estimated annual revenue impact.

EXHIBIT 1.1. ESTIMATED NUMBER OF LIFE INSURERS CLAIMING DEDUCTION AND AMOUNT CLAIMED TAX YEARS 2005-2018



SOURCE: Office of the State Auditor analysis of Division of Insurance premium tax return data.

Based on life insurer data provided by the Division of Insurance, 28 percent of the premiums eligible for the deduction in Tax Year 2018 were from life insurance policies and 72 percent were from health or accident insurance policies written by life insurers (including disability insurance, traditional medical/health insurance, and accidental death and dismemberment insurance). While a large percentage of the group insurance policies purchased by tax-exempt organizations for their employees are likely to be group annuity policies, we did not include them within these figures because annuities are exempt from premium tax due to the Annuity Exemption [Section 10-3-209(1)(d)(IV), C.R.S].

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the Tax-Exempt Organization Deduction would result in a higher tax burden for the 15 insurers who are claiming the deduction. Overall, these 15 insurers were able to deduct $200 million in premiums and saved $3.8 million in premium taxes by claiming the deduction for Tax Year 2018. Comparatively, these insurers received a total of $4.6 billion in insurance premiums in Tax Year 2018 and paid $47 million in premium taxes. This means that the deduction reduced these insurers' taxable premiums and premium tax owed by about 7 percent. If the deduction was eliminated, most of the additional tax burden would fall on three insurance companies that, together, write about 67 percent of the insurance that qualifies for the deduction. To the extent that these insurers would pass the additional 2 percent premium tax on to purchasers, eliminating the deduction could also cause a corresponding increase in costs for tax-exempt employers who purchase these insurance policies.

We contacted seven staff or tax preparers for insurers who took the deduction and five of them indicated that the deduction was important for their company or clients. One said the deduction is not important given that the tax savings only equates to 2 percent of their Colorado tax liability. The remaining individual stated that the deduction was not

significant for their company, but might be significant to their company's clients.

Eliminating the deduction might also result in a higher tax burden for Colorado-domiciled insurers doing business in other states. This is because 49 states (including Colorado) and the District of Columbia have retaliatory insurance provisions in their statutes that allow them to impose taxes or other requirements on out-of-state insurers at the same level that other states impose taxes and requirements on their home-state insurers. Since eliminating the deduction would increase the effective tax rate of these 15 insurers, it is possible that other jurisdictions would respond by raising taxes on Colorado-domiciled insurers. However, as noted below only 15 states have a similar provision.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 48 states (excluding Colorado) and the District of Columbia that levy an insurance premium tax, the following 15 jurisdictions have an insurance premium tax deduction at least partly similar to the Tax-Exempt Organization Deduction: Alabama, Alaska, Arizona, Florida, Illinois, Iowa, Kentucky, Minnesota, Mississippi, Missouri, New Hampshire, New Mexico, Oklahoma, Texas, and Utah. However, there is wide variation in these expenditures across jurisdictions. For example, 13 of these states limit the deduction to some or all public sector employees, four states limit the deduction to health or accident insurance premiums, and one state limits the deduction to life insurance premiums or premiums in connection with retirement plans.

ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

Since 1977, all annuity premiums have been exempt from premium tax in Colorado under the Annuity Exemption [Section 10-3-209(1)(d)(IV), C.R.S.]. Therefore, annuity premiums that qualify for the Tax-Exempt Organization Deduction would also qualify for the Annuity Exemption.

Despite this overlap, taxpayers do not receive a duplicate tax benefit since both provisions function to eliminate the full tax liability for the annuity premiums covered.

In addition, the same 1969 bill that created the Tax-Exempt Organization Deduction also created the Employee Retirement Plan Deduction [Section 10-3-209(1)(d)(IV), C.R.S.] for life insurance and annuity products purchased in connection with corporate employee retirement plans. Premiums that qualify for this deduction would not qualify for the Tax-Exempt Organization Deduction because they are purchased by corporations, which are not included as qualifying organizations.

WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURE?

We could not obtain data to determine if any non-life insurers took the deduction because the Division of Insurance premium tax return form that non-life insurers use does not include a separate line to report the Tax-Exempt Organization Deduction. Instead, any amount claimed for the deduction is aggregated with several other deductions on a line for "Other Deductions." However, the Division indicated that it is unlikely that non-life insurers, such as property/casualty or certain health insurers, would claim the deduction.

To address this issue the Division of Insurance would have to add an additional reporting line specific to the Tax-Exempt Organizations Deduction to its premium tax returns for non-life insurers. However, this change would likely require additional resources and may not be warranted if it is unlikely that these insurers would use the deduction.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

INSURERS MAY LACK CLEAR INSTRUCTIONS ON HOW TO CLAIM THE TAX-EXEMPT ORGANIZATION DEDUCTION. Specifically, the Division of Insurance's filing system and instructions do not clearly indicate how insurers should deduct premiums for insurance purchased by non-profit, charitable, and religious organizations. The Division of Insurance provides no written instructions, other than statutes and regulations, to insurers for how to properly file their insurance premium taxes. In the past, the Division of Insurance provided written instructions; however, when it moved to a fully electronic premium tax filing system in 2007, it phased them out. Further, the space for reporting the deduction on the premium tax return form is labeled as "Political Subdivision" and does not indicate that insurers should also report deductions for other types of tax-exempt organizations, such as non-profits, in this space. While stakeholders told us that it is likely that many insurers' tax preparation staff are broadly aware of how to claim the deduction, staff from one insurer indicated that they were unaware that eligible premiums from non-profits and other tax-exempt organizations were also supposed to be listed in that category. This insurer and one other did claim the deduction in Tax Years 2017 and 2018, using a separate space labeled "Other Deductions" to report it. However, it is possible that other insurers might not be aware that the deduction is not limited to the State's political subdivisions, which could result in some insurers not claiming the deduction even though they would be eligible. According to Division of Insurance staff, it is currently developing updated premium tax filing instructions that will help address this issue.