IN-STATE INVESTMENT PRE-1959 INSURANCE PREMIUM TAX DEDUCTION

EVALUATION SUMMARY

SEPTEMBER 2019
2019-TE28

THIS EVALUATION IS INCLUDED IN COMPILATION REPORT SEPTEMBER 2019

YEAR ENACTED	1959
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	None
NUMBER OF TAXPAYERS	None
AVERAGE TAXPAYER BENEFIT	None
IS IT MEETING ITS PURPOSE?	No, because it is likely not being used.

WHAT DOES THIS TAX EXPENDITURE DO?

The In-State Investment Pre-1959 Insurance Premium Tax Deduction (Pre-1959 Insurance Deduction) allows insurers that are domiciled and maintain their principal place of business in Colorado, and invest at least 30 percent of their assets in-state to deduct pre-1959 policy premiums from their premium tax liability.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state a purpose for the deduction. We inferred that it was created to maintain tax certainty for certain life insurers previously exempt from premium tax, as well as to incentivize them to make in-state investments.

WHAT DID THE EVALUATION FIND?

We determined that the deduction is not providing tax certainty or encouraging in-state investments because it is unlikely that any insurers are using it.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly could consider repealing the Pre-1959 Insurance Deduction since it is unlikely that there are insurers that still benefit from it.

IN-STATE INVESTMENT PRE-1959 INSURANCE PREMIUM TAX DEDUCTION

EVALUATION RESULTS

WHAT IS THIS TAX EXPENDITURE?

Colorado levies a 2 percent premium tax on insurance companies' in-state premiums, which is the revenue insurers collect for writing insurance policies covering property or risks in the state. The In-State Investment Pre-1959 Insurance Premium Tax Deduction (Pre-1959 Insurance Deduction) [Section 10-3-209(1)(d)(III), C.R.S.] allows insurers to deduct the value of the premiums they collect from policies established prior to Calendar Year 1959, if the following four conditions are met:

1. They are domiciled in Colorado for regulatory and tax purposes;
2. They maintain their "principal place of business" in Colorado;
3. They invest 30 percent or more of their assets in state/county/municipal/special district bonds, property and mortgages in Colorado, or deposits/stocks/bonds with Colorado organizations, or organizations that invest 50 percent or more of their assets in Colorado (investments in United States government bonds, bonds from any instrumentality of the United States, and deferred or uncollected insurance premiums and annuity considerations are first deducted before the calculation is made); and
4. The premiums are fixed and "contractually binding upon the company," and therefore, not subject to change after the policy was originally written.

Although the Pre-1959 Insurance Deduction has been amended several times since its creation, it was established in 1959 to substantially maintain the tax treatment of insurance policies that had already been written. From 1959 through 1969, the General Assembly made substantial changes to the tax treatment of in-state insurers for policies written during Calendar Years 1959 and later. Specifically, since 1913, the State had exempted insurers from premium tax if they invested 50 percent or more of their assets in Colorado property or the bonds of Colorado public sector entities. Beginning in 1959, the General Assembly made substantial changes to this provision for policies written during 1959 and later, including increasing the tax rate and changing eligibility requirements.

To claim the Pre-1959 Insurance Deduction, insurers deduct the amount that they are claiming before they report their gross taxable premiums when they file for their Colorado premium tax with the Division of Insurance, within the Department of Regulatory Agencies.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of the deduction. Based on statute and interviews with stakeholders, we inferred that the direct beneficiaries of this deduction are life insurers based in Colorado with significant business operations and investments in the state. We determined that the primary beneficiaries would be life insurance companies because the deduction only applies to premiums that are “fixed and…contractually binding” [Section 10-3-209(1)(d)(III), C.R.S.]. Our research and interviews with insurance industry stakeholders indicate that only life insurance policies and occasionally annuities—both of which are products issued by life insurers—typically have fixed, unchanging premium amounts written into a long-term insurance contract.

Since insurance premium tax expenditures result in a tax savings for insurers, part or all of which is often passed on to policyholders, we inferred that the indirect beneficiaries of the deduction were intended to be Colorado individuals, businesses, and other entities who purchase policies from eligible insurers.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for the Pre-1959 Insurance Deduction. Based on statute and legislative history, we inferred that one purpose of the deduction is to maintain tax certainty for certain life insurers. According to the *Tax Policy Handbook for State Legislators, 3rd Edition* published by the National Conference of State Legislatures "[c]ertainty means that the number and type of tax changes are kept at a minimum to allow businesses and individuals to plan for the future." The same 1959 bill that created the deduction also made certain insurers that were previously exempt from Colorado premium tax, liable for the tax for the first time. Thus, the deduction allowed eligible insurance companies to maintain any life insurance or annuity products in place at the time without reducing their expected profit from them or raising rates for future policyholders, since insurers may not be able to increase the premiums on previously-written life insurance policies and certain annuity contracts.

Additionally, since the Pre-1959 Insurance Deduction applies only to insurers that invest a significant portion of their assets in Colorado, we also inferred that its purpose was to encourage insurers to invest in Colorado-based assets.

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

We found that the Pre-1959 Insurance Deduction is no longer meeting its purposes because few insurers are eligible for it and those who we identified as potentially eligible are already exempt from insurance premium tax based on other tax expenditure provisions.

Statute does not provide quantifiable performance measures for the deduction. Therefore, we created and applied the following performance measures to determine the extent to which the deduction is meeting its inferred purposes:

PERFORMANCE MEASURE #1: *To what extent does the Pre-1959 Insurance Deduction create tax certainty for life insurers and their policyholders?*

RESULT: The deduction is no longer providing tax certainty for life insurers and their policyholders because there are few potentially eligible insurers, and those insurers are already exempt from insurance premium tax based on other tax expenditure provisions. Although the Division of Insurance did not have data available to confirm that no insurance companies have claimed the deduction, its data show that of the 468 insurers licensed in Calendar Year 2018 to issue life insurance policies and/or annuity contracts in Colorado, only nine met the requirement of being domiciled in Colorado. Of those nine, the American Council of Life Insurers, the main trade body for U.S. life insurers, identified six that might still have active policies that were issued prior to 1959. We examined financial statements for four of these six insurers that are commercial insurance companies. Although we were not able to trace all of their listed investments to individual states of origin, we found that it is unlikely that they meet the requirement of investing at least 30 percent of their assets in Colorado-based investments (even after deducting "bonds, notes or other obligations of the United States…or any instrumentality of the United States," per Section 10-3-209[1][f], C.R.S.). This is consistent with our interviews with stakeholders, which indicated that most insurers' investment portfolios are now highly diversified and unlikely to concentrate such a high percentage of assets in one state.

For the other two Colorado-based insurers, which are non-profit fraternal benefit societies, we determined that they may technically qualify for the deduction because, according to their staff, they do invest at least 30 percent of their assets in Colorado-based investments. In addition, one of the staff members estimated that their pre-1959 life insurance policies represent 2 percent of the premiums they collect each year. Therefore, these two insurers may have a small amount of premiums that are eligible for the deduction. However, as fraternal benefit societies, these two insurers are already exempt from all insurance premium tax in Colorado due to the Fraternal Society Exemption [Section 10-3-209(1)(d)(I), C.R.S.].

Moreover, insurance stakeholders we interviewed indicated that a minimal amount of premiums are still being paid on pre-1959 life insurance policies and annuity contracts because such policies would be at least 60 years old in 2019, and it is uncommon for policyholders to continue paying premiums on a policy for that amount of time. For example, if a whole life insurance policy was purchased for an infant in 1958, then the policyholder would have been paying premiums for 61 years and the infant would be at or near retirement age, which, according to stakeholders, is when many policyholders stop paying their premiums and start receiving payouts. In addition, such policies are less valuable to policyholders because they tend to have lower payout values, since their value does not increase with inflation.

However, we found that the Pre-1959 Insurance Deduction likely did create a degree of tax certainty for certain life insurers and their policyholders in the past. In the same 1959 bill that created this deduction, these insurers were subject to a 1 percent premium tax for the first time. Without the deduction, the new tax would have threatened qualifying in-state insurers' expected profits on their life insurance policies and some annuity contracts already in effect. Unlike most other types of insurance policies whose premium rates frequently change and allow insurers to pass on tax increases to policyholders, these policies typically keep the premium amounts fixed once effective and may not allow insurers to pass tax increases on to policy holders. Although we did not have data necessary to quantify the deduction's impact when it was created, it is likely that its impact has gradually diminished since 1959, as the policies it applied to either were paid-out or cancelled.

PERFORMANCE MEASURE #2: *To what extent is the Pre-1959 Insurance Deduction incentivizing insurers to invest in Colorado?*

RESULT: We found that the deduction is not currently incentivizing investment in Colorado because, as discussed above, we only identified two insurers that potentially meet the deduction's eligibility criteria, and these insurers are already exempt from insurance premium tax under the Fraternal Society Exemption. Further, even if these two insurers were not otherwise exempt from premium taxes, it is unlikely that the Pre-1959 Insurance Deduction would be necessary to incentivize them to invest in Colorado assets, since they are already doing so without an added incentive. Additionally, because only a small percentage of premium collections are from policies issued prior to 1959, the value of the deduction would likely be too small to provide a meaningful incentive.

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

Since the only two insurers that we identified that may be potentially eligible to claim the Pre-1959 Insurance Deduction are already exempt from premium tax through the Fraternal Society Exemption, we estimate that there is no revenue impact to the State and no economic costs or benefits associated with the deduction.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the Pre-1959 Insurance Deduction would have little or no impact on beneficiaries because it is likely not being used, and the only two insurers we identified that may be potentially eligible to use it are already exempt from premium tax through the Fraternal Society Exemption.

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 on most types of insurance, the following eight states have insurance premium tax expenditures similar to the Pre-1959 Insurance Deduction that benefit insurers whose in-state investments reach a certain asset threshold: Alabama, Georgia, Iowa, Kansas, Mississippi, Missouri, Tennessee, and West Virginia.

However, none of these states limit their expenditures to policies that were effective before a certain year, and none are specifically geared towards life insurers, as is the case for the Pre-1959 Insurance Deduction.

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

The Regional Home Office Rate Reduction [Section 10-3-209(1)(b)(I)(B), C.R.S.] has a similar purpose as the Pre-1959 Insurance Deduction in that it was established to incentivize insurers to locate their business and invest in Colorado. The Regional Home Office Rate Reduction allows insurers to reduce their premium tax liability by 50 percent if they maintain a "home office" or "regional home office" in Colorado. Insurers meet this threshold if they "substantially perform," within Colorado, actuarial, medical, legal, and other essential functions that cover their Colorado business and often business in surrounding states. They can also meet this threshold if they maintain "significant direct insurance operations" in Colorado that are supported by "functional operations which are both necessary for and pertinent to" their in-state business. According to Division of Insurance data, 85 insurers claimed the Regional Home Office Rate Reduction for a total of $89.7 million in reduced premiums in Tax Year 2018. We will discuss the Regional Home Office Rate Reduction in a separate evaluation.

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

We were unable to confirm that no taxpayers currently claim the deduction since it is not captured on Division of Insurance tax filing forms. Specifically, if any insurers claimed it, they would have subtracted the deduction amount prior to reporting their premium collections and therefore, the Division of Insurance would have no record of it being claimed. If the Division of Insurance added a reporting line to its tax filing forms where insurers could indicate how much they are claiming under the deduction, our analysis could confirm that the deduction is no longer being used. However, adding an additional question to the premium tax filing forms would result in an additional burden on insurers and the Division of Insurance, which would be impractical given that other information sources indicate that it is likely no longer being used.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY COULD CONSIDER REPEALING THE PRE-1959 INSURANCE DEDUCTION SINCE IT IS UNLIKELY THAT INSURERS ARE STILL USING IT AND IT IS NO LONGER MEETING ITS PURPOSE. As discussed, we only identified two insurers that could potentially meet the deduction's eligibility requirements and both are already exempt from insurance premium tax under the Fraternal Society Exemption. Further, few insurers still have policies from prior to 1959 and the minimal number of polices that meet this requirement is likely to continue to decrease. Therefore, the deduction is no longer serving its purposes of creating tax certainty and encouraging in-state investments by insurance companies.