INSURANCE PREMIUMS TAX

Revenue Description

Montana levies a tax of 2.75% on net premiums on all insurance policies (33-2-705, MCA) except health service corporations, which are exempt from all premium taxes under 33-30-203, MCA. There is an additional tax of 2.5% on premiums for fire and casualty insurance on property, insurance of property in transit, insurance against loss or damage to motor vehicles, crop insurance, insurance against water damage, insurance against property damage from vehicle accidents, and insurance against theft of a vehicle (50-3-109, MCA).

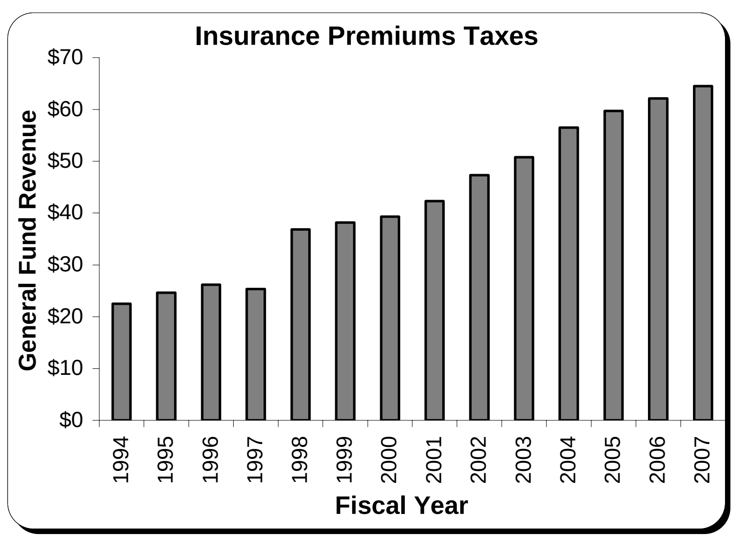
Section 33-2-712, MCA, provides for a genetics program fee of $0.70 per each Montana resident insured under any individual or group disability or health insurance policy. This fee is used to fund the statewide genetics program established in 50-19-211, MCA.

Historical and Projected Revenue

Table 1 shows actual insurance premiums taxes for FY 1994 through FY 2004, and projected revenue for FY 2005 through FY 2007. Prior to FY 1998, a portion of the premiums tax revenue was paid into pension and benefit funds for police officers and firefighters. Beginning in FY 1998, all premiums taxes are deposited in the general fund, explaining the large increase in revenue shown in Table 1 for that year.

Table 1
Insurance Premium Tax - General Fund Collections
($ millions)

	Fiscal Year	General Fund	Percent Change
A	1994	$22.511	
A	1995	$24.600	9.28%
A	1996	$26.166	6.37%
A	1997	$25.342	-3.15%
A	1998	$36.813	45.26%
A	1999	$38.137	3.60%
A	2000	$39.334	3.14%
A	2001	$42.298	7.54%
A	2002	$47.291	11.80%
A	2003	$50.810	7.44%
A	2004	$56.527	11.25%
F	**2005**	**$59.692**	**5.60%**
F	**2006**	**$62.095**	**4.03%**
F	**2007**	**$64.539**	**3.94%**



The forecast anticipates growth in insurance tax revenue to slow in FY 2005 and subsequent years. The growth in premium tax, along with fire and casualty surtax, is expected to be significantly lower than was observed in recent years. Additionally, because a large health service corporation, which does not pay the insurance premiums tax, assumed a company previously paying the insurance premium tax, the State Auditor's Office expects a $600,000 per year decrease in the premium tax.

Forecast Methodology and Projection Calculation

Insurance premiums tax receipts depend on the value of insurance premiums, and on deductions that insurance companies are allowed to take against their tax liabilities. Genetics program fees depend on the number of residents covered by disability and health insurance policies.

Insurance Premiums Tax

An insurance company's premiums tax liability is the tax rate multiplied by its annual premiums, less deductions. Total premiums depend on the amount of insurance coverage that consumers and businesses buy, and the price that insurance companies charge for that coverage.

The price of insurance is influenced by insurance companies' investment earnings. Insurance companies set their rates so that the sum of premiums and investment earnings will pay the average level of claims, along with dividends to the owners. Insurance companies maintain reserves to cover unexpected high claims. They invest these reserves in corporate and government securities, mortgages, real estate, and other assets. When income from these investments is high, insurance companies can reduce their rates. When investment income is low, insurance companies must raise their rates. The dramatic run-up in the price of stocks from 1996 through 2000 gave insurance companies unexpected capital gains, which allowed them to hold down rates.

In FY 1998 and FY 1999, premiums tax revenue decreased, as capital gains from the rising stock market allowed insurance companies to reduce premiums. Average stock prices grew slower in FY 2000, peaked and began to fall in FY 2001, and plunged in FY 2002. As the stock market slowed, insurance companies were no longer able to reduce rates, and total premiums began to grow again. Beginning in FY 2002, insurance companies were forced to raise their rates, and premiums tax revenues grew much faster than normal.

Insurance premiums tax, before any tax offsets, grew by approximately 10% each year from FY 2002 to FY 2004. However, as the stock market recovers and interest rates rise, earnings from these sources should decrease the upward pressure on premiums. The top portion of Table 2 shows growth in the base premiums tax, before offsets for FY 1998 through FY 2004. The average annual growth in base premiums tax from FY 1998 to FY 2004 was 6.75%.

The average annual growth of 6.75% is used to estimate base premiums tax for FY 2005. However, a downward adjustment of $600,000 is made to account for the aforementioned health service corporation assuming another insurance business. As Table 2 shows, the ($600,000) adjustment reduces estimated growth to 5.55% for FY 2005.

The stock market and interest rates are expected to have a more robust earning potential in FY 2006 and FY 2007. It is assumed that with more robust earnings, insurance companies will be able to hold premiums down. FY 2006 and FY 2007 base insurance premiums tax revenue is projected using a 4.0% growth rate.

Table 2
Insurance Premiums Tax Growth Before Offsets

Fiscal Year	Base Premiums Tax Before Offsets ($ million)	% Growth
1998	$36.211	
1999	$35.674	-1.48%
2000	$37.834	6.06%
2001	$39.874	5.39%
2002	$44.803	12.36%
2003	$48.630	8.54%
2004	$53.582	10.18%
6 Year Average Growth	**=**	**6.75%**
2005	$56.558	5.55%
2006	$58.820	4.00%
2007	$61.173	4.00%

Insurance Premiums Tax - Offsets

Companies are allowed to deduct amounts they are assessed by the Montana Life and Health Insurance Guarantee Association (MLHIGA) and the Montana Comprehensive Health Association (MCHA).

MLHIGA protects policyholders against insurance company insolvencies. When an insurance company doing business in Montana becomes insolvent, MLHIGA covers its liabilities by making assessments against all the other insurance companies. These assessments may last for up to five years. MLHIGA assessments were unusually high in the mid-1990s because of the bankruptcy of a single large insurance company. As Table 3 shows, MLHIGA assessments have been decreasing since FY 1998, and the State Auditor's Office expects them to continue to decrease during the forecast period.

MCHA subsidizes health insurance for high-risk individuals, such as people with serious pre-existing conditions. In most years, the sum of premiums paid by high-risk policyholders is less than their total claims. MCHA reimburses companies that insure high-risk individuals for their losses on these policies. It covers these losses by making assessments against the other insurance companies. Blue Cross Blue Shield (BCBS) administers the MCHA program; BCBS anticipates the amount of MCHA reimbursements to be $910,000 in FY 2005, and then increase by 5% each year.

Table 3
MLHIGA and MCHA Offsets
($ millions)

Fiscal Year	MHLIGA Offsets	MCHA Offsets	Total Offsets
1998	$2.801	$0.229	$3.030
1999	$1.936	$0.702	$2.638
2000	$1.354	$0.729	$2.083
2001	$0.587	$0.274	$0.861
2002	$0.259	$0.481	$0.740
2003	$0.374	$1.089	$1.463
2004	$0.368	$0.957	$1.325
2005	**$0.218**	**$0.910**	**$1.128**
2006	**$0.165**	**$0.955**	**$1.120**
2007	**$0.165**	**$1.003**	**$1.168**

As Table 3 shows, total offsets are projected at $1.128 million for FY 2005, $1.120 million in FY 2006, and $1.168 million in FY 2007

Surtax on Fire and Casualty Insurance

Table 4 shows actual and projected surtax revenue collections on fire and casualty insurance for FY 2000 through FY 2007. As Table 4 illustrates, surtax revenue, like the base insurance premium tax, grew significantly from FY 2000 to FY 2004.

The forecast assumes that growth in surtax revenue on fire and casualty insurance will follow the growth in the base insurance premium tax. As previously discussed, the unadjusted growth in the base insurance tax is projected at 6.75% for FY 2005, and 4.00% for FY 2006 and FY 2007. Using these growth rates yields estimated surtax revenue of $3.277 million in FY 2005, $3.408 million in FY 2006, and $3.544 million in FY 2007.

Table 4
Insurance Premiums
Fire/Casualty Surtax

Fiscal Year	Surtax ($ millions)	% Growth
2000	$2.012	
2001	$2.206	9.63%
2002	$2.367	7.34%
2003	$2.701	14.09%
2004	$3.070	13.65%
2005	**$3.277**	**6.75%**
2006	**$3.408**	**4.00%**
2007	**$3.544**	**4.00%**

Genetics Program Fees

Section 50-19-211, MCA, provides for a voluntary genetics program designed to offer testing, counseling, and education to parents and prospective parents. A fee, paid by insurers or health service corporations, of $0.70 for each Montana resident insured under any individual or group disability or health insurance policy, funds this program. The fee is deposited in the general fund.

Table 5 shows actual and projected genetics program fees from FY 1994 through FY 2007. In recent years, the number of insured persons has varied from 86% to 100% of the population. The percentage fluctuates from year to year due to changes in the percent of uninsured persons, and persons covered by more than one policy. The forecast assumes that the number of insured persons will remain at the FY 2004 level of 90.1% of the state population for FY 2005 through FY 2007.

Table 5
Genetics Program Fee

Fiscal Year	State Population		Percent Insured		Insured Persons		Fee per Insured Person		General Fund Revenue
A 1998	895,601	x	91.6%	=	820,584	x	$0.70	=	$574,409
A 1999	901,175	x	91.8%	=	827,135	x	$0.70	=	$578,995
A 2000	904,988	x	85.6%	=	774,854	x	$0.70	=	$542,398
A 2001	908,714	x	99.8%	=	907,003	x	$0.70	=	$634,902
A 2002	914,898	x	89.0%	=	813,987	x	$0.70	=	$569,791
A 2003	920,103	x	87.5%	=	804,855	x	$0.70	=	$563,399
A 2004	924,064	x	90.1%	=	832,794	x	$0.70	=	$582,956
F 2005	**927,900**	**x**	**90.1%**	**=**	**836,251**	**x**	**$0.70**	**=**	**$585,375**
F 2006	**931,566**	**x**	**90.1%**	**=**	**839,555**	**x**	**$0.70**	**=**	**$587,688**
F 2007	**935,331**	**x**	**90.1%**	**=**	**842,948**	**x**	**$0.70**	**=**	**$590,064**

General Fund Revenue

Table 6 shows general fund revenue forecasts for FY 2005 through FY 2007. Total revenue to the general fund is the sum of insurance premiums tax minus the offsets, plus the surtax, the genetics fee, and various insurance licenses and permits.

Table 6
Total Insurance Premiums Tax General Fund Collections
($ millions)

Fiscal Year	Insurance Premiums Tax		Offsets		Fire/Casualty Surtax		Genetics Fee		Licenses & Permits		General Fund Revenue
F 2005	**$56.558**	**-**	**$1.128**	**+**	**$3.277**	**+**	**$0.585**	**+**	**$0.400**	**=**	**$59.692**
F 2006	**$58.820**	**-**	**$1.120**	**+**	**$3.408**	**+**	**$0.588**	**+**	**$0.400**	**=**	**$62.095**
F 2007	**$61.173**	**-**	**$1.168**	**+**	**$3.544**	**+**	**$0.590**	**+**	**$0.400**	**=**	**$64.539**

The amount of revenue received for various insurance licenses and permits has averaged approximately $400,000 per year since FY 2002. For purposes of this analysis, $400,000 per year is used to estimate various insurance licenses and permits over the forecast period.

Total general fund insurance premiums tax revenue is projected to be $59.7 million in FY 2005, $62.1 million in FY 2006, and $64.5 million in FY 2007.