

## INSURANCE PREMIUMS TAX

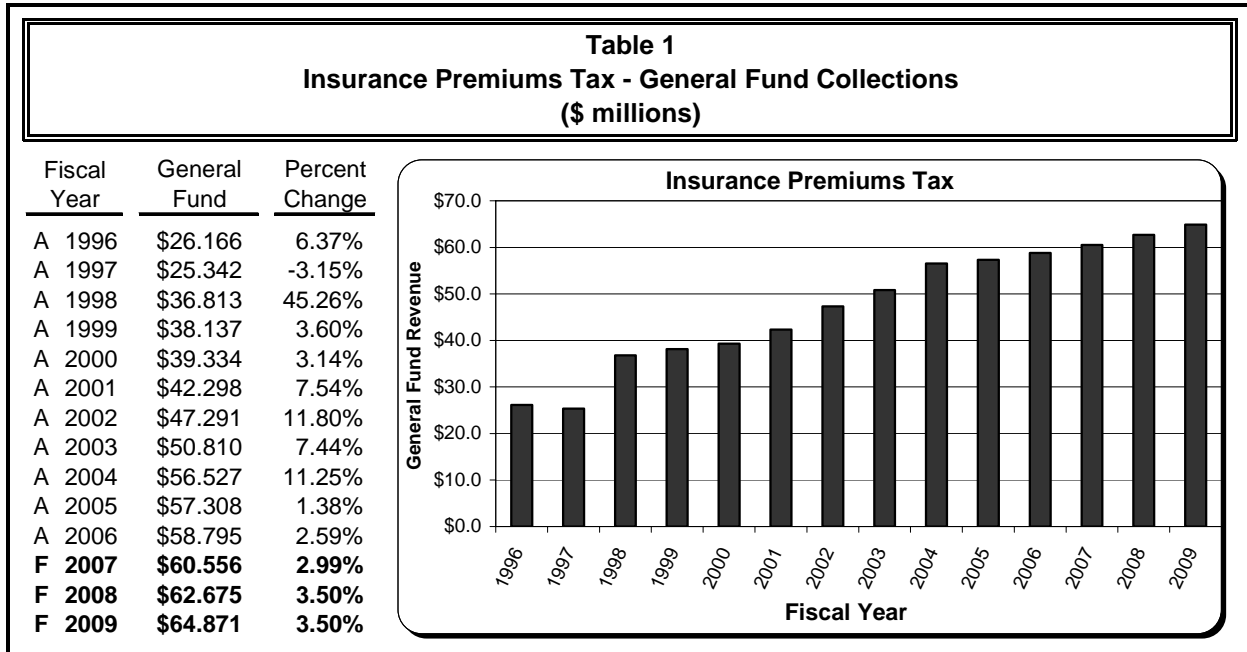
### Revenue Description

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 for each Montana resident insured under any individual or group disability or health insurance policy. The fee is used to fund the statewide genetics program established in 50-19-211, MCA. The 2005 Legislature passed SB 275 which increased the fee from \$0.70 to \$1.00 until June 30, 2007, and directed that the fee revenues be deposited in a state special revenue account instead of the general fund as had been the case in prior years.

### Historical and Projected Revenue

Table 1 shows actual general fund revenue from the insurance premium tax for FY 1996 through FY 2006 and forecast revenue for FY 2007 through FY 2009.



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 45.26% increase in revenue shown in Table 1 for that year. In April 2004 a large health service corporation, which does not pay the insurance premium tax, assumed a company previously paying the insurance premium tax. The State Auditor's Office estimates that the change represents a decline in annual net revenues of about \$530,000 per year.

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, for each Montana resident insured under any individual or group disability or health insurance policy, funds this program. In the 2005 Session (SB 275), the Legislature changed the fee amount and the disposition of the fee revenues from the general fund to a state special revenue fund (50-19-212, MCA). Prior to enactment of SB 275, genetics fee revenue was included in general fund insurance premium revenue. In FY 2005 these fees were \$0.635 million.

The forecast anticipates relatively low, but steady growth in insurance tax revenue in FY 2007, increasing by 3.78% to \$61.0 million. Insurance tax revenues are projected to increase by 4.25% to \$63.6 million in FY 2008 and increase by 4.26% to \$66.3 million in FY 2009.

### **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. Insurance premiums taxes are forecast using the following procedure. First insurance premiums taxes before offsets and without the genetics fee revenues are calculated. Then offsets to insurance premiums taxes are forecast. Next the surtax on fire and casualty insurance is projected. Finally net insurance premiums tax revenue, after offsets are taken out and revenues from the surtax and licenses and permits are included, is calculated.

#### **Insurance Premiums Tax Growth**

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 the mid-1990s through 2000 gave insurance companies unexpected capital gains, which allowed them to hold down rates.

In 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 faster than normal. Insurance premiums tax, before any tax offsets and without genetics fee revenues, grew between 8.7% and 12.7% annually from FY 2002 to FY 2004. However, the stock market recovery and recent increases in interest rates should mean that earnings from other sources will mitigate upward pressures on premiums.

Table 2 shows that the annual growth rates for the base premiums tax, before offsets and without genetics fee revenues, for FY 1998 through FY 2006. The average annual growth rate was 5.88% over that period. However, the growth rate in premiums taxes declined to 3.89% in FY 2005 and 2.54% in FY 2006, reflecting both the effect of better performance of other earnings sources and the reduction in revenues due to the aforementioned health service corporation assuming another insurance business. The average growth rate for FY 2005 through FY 2006 is 3.21%.

The stock market and interest rates are expected to continue to provide earnings potential in the forecast period. With continued performance in other earnings, it is expected that insurance companies will not have to raise premiums substantially as they have in past periods when other earnings declined. Therefore, the average growth of 3.21% for the two most recent fiscal years, FY 2005 and FY 2006, is used to estimate base premiums tax for FY 2007 through FY 2009.

| <b>Table 2</b><br><b>Insurance Premiums Tax Growth</b><br><b>Before Offsets &amp; without Genetics</b><br><b>Fees</b> |  |              |
|---|--|--------------|
| Fiscal Year   | Revenues without Genetics Fee (\$ million) | % Growth     |
| A 1998  | \$35.636                                   | 4.39%        |
| A 1999  | \$35.095                                   | -1.52%       |
| A 2000  | \$37.291                                   | 6.26%        |
| A 2001  | \$39.239                                   | 5.22%        |
| A 2002  | \$44.233                                   | 12.73%       |
| A 2003  | \$48.067                                   | 8.67%        |
| A 2004  | \$52.836                                   | 9.92%        |
| A 2005  | \$54.891                                   | 3.89%        |
| A 2006  | \$56.283                                   | 2.54%        |
| <b>Avg Growth (FY05, FY06)</b>  |  | <b>3.21%</b> |
| F 2007  | \$58.091                                   | 3.21%        |
| F 2008  | \$59.956                                   | 3.21%        |
| F 2009  | \$61.881                                   | 3.21%        |

### 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 to \$0.165 million 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 \$1,195,000 in FY 2007. BCBS indicates that the formula underlying the offsets has been revised, and, therefore, annual offsets are not expected to vary as much as they have in the past. FY 2008 and FY 2009 offsets are estimated to be the same as in FY 2007.

As Table 3 shows, total offsets are projected at \$1.360 million for FY 2007 through FY 2009.

| <b>Table 3<br/>MLHIGA and MCHA Offsets<br/>(\$ millions)</b> |                       |                     |                      |
|--|-----------------------|---------------------|----------------------|
| <b>Fiscal Year</b>   | <b>MHLIGA Offsets</b> | <b>MCHA Offsets</b> | <b>Total Offsets</b> |
| A 1998   | \$2.801               | \$0.229             | \$3.030              |
| A 1999   | \$1.936               | \$0.702             | \$2.638              |
| A 2000   | \$1.354               | \$0.729             | \$2.083              |
| A 2001   | \$0.587               | \$0.274             | \$0.861              |
| A 2002   | \$0.259               | \$0.481             | \$0.740              |
| A 2003   | \$0.374               | \$1.089             | \$1.463              |
| A 2004   | \$0.368               | \$0.793             | \$1.161              |
| A 2005   | \$0.382               | \$1.268             | \$1.650              |
| A 2006   | \$0.311               | \$0.805             | \$1.116              |
| <b>F 2007</b>  | <b>\$0.165</b>        | <b>\$ 1.195</b>     | <b>\$1.360</b>       |
| <b>F 2008</b>  | <b>\$0.165</b>        | <b>\$1.195</b>      | <b>\$1.360</b>       |
| <b>F 2009</b>  | <b>\$0.165</b>        | <b>\$1.195</b>      | <b>\$1.360</b>       |

### 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 2009. As Table 4 illustrates, surtax revenue, like the base insurance premium tax, grew significantly from FY 2000 to FY 2006. The average annual growth rate was 9.2% over the entire period. However, the high average growth rate is based on a period that includes unusually high increases in surtax revenues – 14% in FY 2003 and 13.6% in FY 2004. For purposes of the forecast these two unusually high growth rate years are excluded from the average growth rate applied to future years.

| <b>Table 4<br/>Insurance Premiums<br/>Fire/Casualty Surtax</b> |                             |                 |
|--|-----------------------------|-----------------|
| <b>Fiscal Year</b>   | <b>Surtax (\$ millions)</b> | <b>% Growth</b> |
| A 2000   | \$2.012                     |                 |
| A 2001   | \$2.206                     | 9.63%           |
| A 2002   | \$2.367                     | 7.34%           |
| A 2003   | \$2.701                     | 14.09%          |
| A 2004   | \$3.070                     | 13.65%          |
| A 2005   | \$3.214                     | 4.71%           |
| A 2006   | \$3.412                     | 6.14%           |
| <b>Avg Growth (FY01, FY02, FY05, FY06)</b>                     |                             | <b>6.96%</b>    |
| <b>F 2007</b>  | <b>\$3.649</b>              | <b>6.96%</b>    |
| <b>F 2008</b>  | <b>\$3.903</b>              | <b>6.96%</b>    |
| <b>F 2009</b>  | <b>\$4.175</b>              | <b>6.96%</b>    |

The forecast assumes that growth in surtax revenue on fire and casualty insurance will follow the average annual growth rate of 6.96% for FY 2000 through FY 2006 excluding FY 2003 and FY 2004. Using this growth rates yields estimated surtax revenue of \$3.649 million in FY 2007, \$3.903 million in FY 2008, and \$4.175 million in FY 2009.

General Fund Revenue

Table 5 shows general fund revenue forecasts for FY 2007 through FY 2009. Total revenue to the general fund is the sum of insurance premiums tax minus the offsets, plus the surtax and various insurance licenses and permits.

| <b>Table 5</b>   |                               |                  |                             |                               |                             |                |                   |
|--|-------------------------------|------------------|-----------------------------|-------------------------------|-----------------------------|----------------|-------------------|
| <b>Total Insurance Premiums Tax General Fund Collections</b> |                               |                  |                             |                               |                             |                |                   |
| <b>(\$ millions)</b>   |                               |                  |                             |                               |                             |                |                   |
| <b>Fiscal Year</b>   | <b>Insurance Premiums Tax</b> | <b>Offsets</b>   | <b>Fire/Casualty Surtax</b> | <b>Licenses &amp; Permits</b> | <b>General Fund Revenue</b> |                |                   |
| <b>F 2007</b>  | <b>\$58.091</b>               | <b>- \$1.360</b> | <b>+</b>                    | <b>\$3.649</b>                | <b>+</b>                    | <b>\$0.176</b> | <b>= \$60.556</b> |
| <b>F 2008</b>  | <b>\$59.956</b>               | <b>- \$1.360</b> | <b>+</b>                    | <b>\$3.903</b>                | <b>+</b>                    | <b>\$0.176</b> | <b>= \$62.675</b> |
| <b>F 2009</b>  | <b>\$61.881</b>               | <b>- \$1.360</b> | <b>+</b>                    | <b>\$4.175</b>                | <b>+</b>                    | <b>\$0.176</b> | <b>= \$64.871</b> |

The amount of revenue received for various insurance licenses and permits has averaged approximately \$176,000 per year from FY 2002 through FY 2006. For purposes of this analysis, the average of \$176,000 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 \$61.0 million in FY 2007, \$63.6 million in FY 2008, and \$66.3 million in FY 2009.

**Data Sources**

Information on MLHIGA and MCHA assessments was provided by the State Auditor's Office. Additional information on MCHA assessments was provided by Blue Cross Blue Shield. Revenue data is from the state accounting system, SABHRS, the MTGL0109 reports.