Approved: 3-22-00
Date

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE.

The meeting was called to order by Chairperson Senator Audrey Langworthy at 11:15 a.m. on March 16, 2000, in Room 519-S of the Capitol.

All members were present except: Senator Greta Goodwin – Excused

Committee staff present: Chris Courtwright, Legislative Research Department
April Holman, Legislative Research Department
Don Hayward, Revisor of Statutes Office
Shirley Higgins, Committee Secretary

Conferees appearing before the committee: Kathleen Sebelius, Insurance Commissioner
Bill Sneed, Attorney at Law

Others attending: See attached list.

<u>Briefing on the decline in insurance premium tax receipts</u>

Senator Langworthy reminded the Committee that substantial changes were made in the premium tax law during the 1997 Legislative Session. She called upon the Insurance Commissioner, Kathleen Sebelius, to present an update on the premium tax issue.

Commissioner Sebelius called attention to a handout prepared to accompany her slide presentation. She began by explaining that in 1985 the U.S. Supreme Court ruled that a differential in premium tax is unconstitutional, which basically meant foreign companies could not be charged a different rate than domestic companies. Kansas had a law in place that charged foreign companies two percent and domestic companies one percent. Between 1985 and 1995, that law was not changed in Kansas. Ten states had been sued under this Supreme Court ruling during that period of time, and all had lost. After the Kansas Insurance Department began investigating the issue in 1995, the Department estimated that the liability for the foreign insurance companies was approximately $500 million. The issue was addressed by the Legislature in 1997 in **<u>HB 2082</u>**. Due to tax reductions resulting from **<u>HB 2082</u>**, premium tax receipts were lower in fiscal year 1999. The Commissioner explained that the primary reason for a $20 million dip in premium tax receipts is attributable to a job credit available to insurance companies that employ Kansas residents. She discussed five options that either the 2000 or 2001 Legislature could consider to mitigate further premium tax revenue loss. In this regard, she called attention to a copy of a memorandum to the Director of the Budget dated December 23, 1999, which outlines options to existing premium tax provisions. Also included in her testimony packet is a copy of a memorandum on the same subject to the Chairman of the Senate Committee on Financial Institutions and Insurance dated February 8, 2000. Included with that memorandum is information regarding tax estimates for fiscal years 2000 and 2001 and information on companies claiming salary credit for tax year 1999. Should the Legislature choose to make any changes in the law, she strongly urged that the effective date be tax year 2000 because insurers have already calculated and prepaid tax year 1999 changes. <u>(Attachment 1)</u>

Bill Sneed, an attorney who represents numerous insurance companies, called attention to copies of his written testimony which includes the historical background previously presented by Commissioner Sebelius. He explained that, after the Commissioner made her presentation to the Senate Financial Institutions and Insurance Committee, the Chairman requested that representatives of the insurance industry review the issue. He called attention to page three of his written testimony where the analysis of the effect of **<u>HB 2082</u>** begins. Attached to his testimony is a comparison table used by the conference committee in 1997 in the process of approving **<u>HB 2082</u>**. He explained that some of the numbers used in 1997 simply were incorrect. As such, the shortfall was larger than anticipated. Mr. Sneed then discussed the perspective which resulted from he working group's review of the situation as is outlined in his written testimony. <u>(Attachment 2)</u>

Senator Langworthy began a brief discussion on a previously heard bill, **Substitute for HB 2702**, concerning a property tax exemption for greenhouse machinery and equipment. She recalled that the bill was amended with regard to an exemption for windmills and solar power as suggested by Mark Beck, Director of the Property Valuation Division.

Senator Praeger moved to recommend **Substitute for HB 2702** as amended favorable for passage, seconded by Senator Lee. The motion carried.

The meeting was adjourned at 12:03 p.m.

The next meeting is scheduled for March 20, 2000.

SENATE ASSESSMENT AND TAXATION COMMITTEE
GUEST LIST

DATE: March 16, 2000

NAME	REPRESENTING
Kathleen Sebelius	
Anne Spiess	Peterson Public Affairs Group
Trish Heim	SBG
Jim Hall	ACLI
David Hanson	Ks Insur Assns
Ned Wilson	Farmers Alliance
Kevin Davis	Am. Family Ins
Lee WRIGHT	FARMER'S INS
Linda J. DeCoursey	KS Insurance Dept
Mel Scott	Kan. Ins Dept
Roger Swartz	Kan. Ins. Dept.
Kathy Olsen	Ks Bankers Assn
Jim Langford	DOB
Mary Ann Heckman	Universal Underwriters Group
Bill Sneed	Polsinelli White
Kathy Damron	Prudential
Matt Goddard	HeartLand Community Bankers
Ashley Sherard	O. P. Chamber

PRESENTATION

TO

SENATE COMMITTEE ON

ASSESSMENT AND TAXATION

Senator Audrey Langworthy, Chair

March 16, 2000
Kansas Insurance Department

Kathleen Sebelius
Insurance Commissioner

Senate Assessment + Taxation
3-16-00
Attachment 1

Issue: Equalize Premium Taxes

- 1985 United States Supreme Court ruling that differential in premium tax is unconstitutional.
- Estimated liability in 1997 from foreign insurance companies was $500.0 million.

Legislative Response

In order to meet the Supreme Court guidelines taxes had to be equalized between foreign and domestic carriers. Choices were:

1. Lower premium taxes to 1.0 percent across-the-board (cut in half the taxes on foreign insurers – passed House).
2. Raise taxes to 2.0 percent across-the-board (double the taxes on domestic insurers).
3. Equalize tax and allow for salary credits for both foreign and domestic insurers (KID recommendation 1997 legislation).

HB 2082

(passed House and Senate effective with tax year 1998)

1. Equalized premium taxes at 2.0 percent for foreign and domestic insurers.
2. Salary tax credit provisions:
   Tax Year 1998
   - Allows a credit against 25.0 percent of salaries paid to Kansas employees, with a 1.0 percent cap.

   Tax Year 1999 (and subsequent tax years)
   - Allows a credit against 30.0 percent of salaries paid to Kansas employees, with a 1.25 percent cap.
3. In addition, legislators chose to eliminate the privilege tax and annuity tax, and modify retaliatory taxes ($4.2 million); phase in for foreign companies additional tax credits for state fire marshal office and firefighters relief tax ($250,000).

Receipts

	Premium Tax	Privilege Tax
FY 1998	$84,909,825	$2,112,535
FY 1999	$64,306,261*	($1,191,386)

- 150 (25 domestic) of 1,600 companies licensed in Kansas took salary credits.
- Foreign companies that received tax credits had a salary base in Kansas of $250.0 million.
- Domestic companies that received tax credits had a salary base of $179.0 million.

*In addition to tax reductions due to HB 2082, premium tax receipts were $2.0 million lower because of guaranty assessments.

Options to Mitigate Further Premium Tax Revenue Loss

1. Beginning with tax year 2000, roll back to 25.0 percent or lower the amount of salaries paid to Kansas employees that can be used for the credit. (Estimate $1.0 million savings for every percentage.)
2. Beginning with tax year 2000, roll back to 1.0 percent, or lower, cap on the amount of credit that can be taken against total premium tax liability ($6.25 million for every one-fourth of one percent).
3. Combine Options 1& 2 by reducing the percent of salaries AND rolling back the credit cap. For example, reduce credit to 20.0 percent of salaries ($5.0 million) plus reduce cap to .75 percent of premium tax ($6.25 million). Total savings $11.25 million per year.

Options to Mitigate Further Premium Tax Revenue Loss

(continued)

4. Repeal current language that allows companies to allocate Kansas salaries to affiliate companies.
5. Combine Options 3 & 4. (Total savings depends on final figures used.)

Note: In the options listed, tax year 2000 is proposed as the effective date because companies have already prepared and submitted tax year 1999 returns.

COPY

Memorandum

To: Senator Don Steffes, Chairman
Senate Committee on Financial Institutions and Insurance

From: Sabrina Wells, Kansas Insurance Department

Date: February 8, 2000

Re: Options to Existing Premium Tax Provisions

This memo is in response to your January 26 request for (1) an estimate of premium tax receipts in future fiscal years under existing law, (2) the effect on premium tax receipts when the salary tax credit is adjusted both up and down, (3) a comparison of tax rates in other states, and (4) options that might mitigate further loss in premium tax revenues to the state.

Attached, please find a table with premium tax receipt estimates of the Consensus Revenue Estimating Group. The Insurance Department worked with the Group in preparing these estimates for the November, 1999 meeting. Also, attached is data that was gathered on the approximately 150 insurance companies that took the salary credit in the first tax year that the credit was effective, tax year 1998.

1. **Premium tax receipt estimates for future fiscal years -** As noted above, an attached sheet details premium tax estimates for FY 2000 and FY 2001. To summarize, current estimates total $62.0 million for FY 2000 and $60.0 million for FY 2001.

2. **The relationship of premium tax receipts when the salary tax credit is adjusted both up and down –** The following estimate is based on first-year experience with the salary credit. For tax year 1998, a salary credit was allowed for the smaller amount of: 25.0 percent of the total amount of Kansas salaries, or up to 1.0 percent of the company's total premium tax liability.

   Based on premium collections under the current law, and those companies claiming the credit under the 25.0 percent provision, the Department estimates that for every

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one percentage point above the 25.0 percent limit, the state loses $1.0 million in premium tax revenue. Conversely, *reducing* the allowable percentage of total Kansas salaries eligible for the credit would *increase* premium tax receipts by an estimated $1.0 million for every one percentage point that the credit is reduced.

Further, based on the first-year's experience with the salary credit and those companies where the cap of 1.0 percent of taxable premiums was invoked, the Insurance Department estimates that for every "roll-back" of one-quarter of one percent of this cap, the state could potentially increase revenues by $6.25 million.

NOTE: That for tax year 1999, and successive tax years, existing law allows companies to take 30.0 percent of their Kansas salaries up to 1.25 percent of their premium tax liability.

3. As the Commissioner shared with the Senate Committee on Financial Institutions and Insurance on January 24, the following premium tax rates are in effect in neighboring states: Missouri is at 2.0 percent, Nebraska is at 1.0 percent, Oklahoma is at 2.25 percent, Iowa is at 2.0 percent, and Colorado is at 2.05 percent.

4. **Options to mitigate further premium tax revenue loss –**

Option One - Beginning with tax year 2000, roll back to 25.0 percent or lower the amount of salaries paid to Kansas employees that can be used for the credit. ($1.0 million savings for every percentage.)

Option Two - Beginning with tax year 2000, roll back to 1.0 percent, or lower, the cap on the amount of credit that can be taken against total premium tax liability. ($6.25 million for every one-fourth of one percent.)

Option Three- Combine Options 1 & 2 by reducing the percent of salaries AND rolling back the credit cap. For example, reduce credit to 20.0 percent of salaries ($5.0 million) plus reduce cap to .75 percent of premium tax ($6.25 million). Total savings $11.25 million per year.

Option Four - Repeal current language that allows companies who have "maxed-out" on the allowable salary credit that they can take, to then allocate remaining Kansas salaries to affiliate companies who then may also take a salary credit. (Unless hand-counted, we don't have estimated savings.)

Option Five – Combine Options 3 & 4. (Total savings depends on final figures used.)

Note: In the options listed, tax year 2000 is proposed as the effective date because companies are already preparing tax returns under current law for tax year 1999. These returns are due March 1, 2000 to the Insurance Department.

FY 2000 and FY 2001 Tax Estimate
Kansas Insurance Department

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	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	
Privilege Tax	$1,001,198	$2,112,535	(1,191,386)	-	-	1
Foreign and Domestic	78,664,361	84,909,825	64,306,261	58,600,000	56,600,000	2
Premium Tax	4.74%	7.94%	-24.27%	-8.87%	-3.41%	
(Decline in dollar amount.)			(20,603,564)	(5,706,261)	(2,000,000)	
Fire Marshal Tax	197,656	200,000	200,000	200,000	200,000	
Retaliatory Tax	1,656,382	2,996,667	2,787,877	2,800,000	2,800,000	
TOTAL PREMIUM TAX	80,518,399	88,106,492	66,102,752	61,600,000	59,600,000	
Fines and Penalties	767,625	440,515	410,764	400,000	400,000	
Total	$82,287,222	$90,659,542	$ 66,513,515	$ 62,000,000	$ 60,000,000	

1. HB 2082 eliminated the privilege tax beginning with tax year 1998.

2. Reduction reflects a new salary credit (loss of $14.3 in foreign tax receipts, small business credit (loss of $1.06 million), repeal of tax on annuity income ($1.0 million), and larger credits taken in tax year 1998 for guaranty assessments ($2.0 million).

Note: For tax year 1999, companies will be able to take the larger of (a) up to 30.0 percent (formerly 25.0 percent) of Kansas salaries as a job credit against their premium tax liability. Or, a company may take a credit, that will reduce their tax liability no lower than 1.25 percent (formerly 1.0 percent).
The scheduled percentage increases will decrease premium tax receipts by an estimated $5.0 million.

Companies Claiming Salary Credit - Tax Year 1998

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COMPANY	SALARY BASE	SALARY CREDIT	Taxable Premiums	1.0 % Cap
FOREIGN COMPANIES				
1 Advance Insurance Company	1,004,219	82,298	8,229,787	Yes
2 Agricultural Insurance Company	-	7,747	774,652	Yes
3 American Casualty Company of Reading Pennsylvania	620,528	37,063	3,706,267	Yes
4 American Family Life Insurance Co.	58,815	14,704	13,325,181	
5 American Fidelity Assurance Company	773,588	96,412	9,641,248	Yes
6 American Fire & Casualty Company	-	13,439	1,343,881	Yes
7 American Economy Insurance Company	3,126,165	146,558	14,655,846	Yes
8 American Foundation Life Insurance Comp.	-	99	9,916	Yes
9 American Health & Life Insurance Company	-	28,629	2,864,124	Yes
10 American Investors Life Insurance Company	-	533	53,272	Yes
11 American Manufacturer's Mutual	-	27,707	2,770,136	Yes
12 American Mercury Insurance Company	1,414,050	10,539	1,053,878	Yes
13 American Motorists Insurance Company	-	81,696	8,169,617	Yes
14 American National Fire Insurance Company	-	9,453	945,260	Yes
15 American Protection Insurance Company	-	38,737	3,873,692	Yes
16 American Spirit Insurance Company	-	75	7,473	Yes
17 American Standard Insurance Company of Wisconsin	761,318	190,330	35,659,306	
18 American States Insurance Company	5,290,434	249,027	24,902,720	Yes
19 American States Preferred Insurance Comp.	3,366,640	162,194	16,219,355	Yes
20 Assurance Company of America	969,968	65,529	6,552,886	Yes
21 Automobile Insurance Comp. Of Hartford, Connecticut	-	4,247	424,677	Yes
22 Canada Life Assurance Company	-	10,648	1,064,805	Yes
23 Central States Indemnity Company	143,120	10,220	1,022,001	Yes
24 Charter Oak Fire Insurance Company	-	22,988	2,298,762	Yes
25 Colonial Life & Accident	125,807	31,452	4,312,519	
26 Connecticut General Life Insurance Company	1,684,959	179,034	17,903,380	Yes
27 Continental Assurance Company	461,993	25,838	2,583,849	Yes

Companies Claiming Salary Credit - Tax Year 1998

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	COMPANY	SALARY BASE	SALARY CREDIT	Taxable Premiums	1.0 % Cap
28	Continental Casualty Company	5,084,825	300,475	30,047,561	Yes
29	Continental Insurance Company	2,645,865	158,992	15,899,182	Yes
30	Crum & Forester Indemnity Company	-	7	744	Yes
31	Cuna Mutual Insurance Society	560,163	114,784	11,478,359	Yes
32	Cuna Mutual Life Insurance Company	138,631	15,402	1,540,151	Yes
33	Emcasco Insurance Company	-	235,293	23,484,812	Yes
34	Employers Mutual Casualty Company	3,250,529	204,207	20,420,722	Yes
35	Employers Reinsurance Corporation	88,598,329	4,991	4,991,260	Yes
36	Farmers Insurance Exchange	24,087,627	84,629	8,462,929	Yes
37	Farmers Casualty Company Mutual	365,582	1,477	14,600,668	Yes
38	Farmers Mutual Hail Insurance Company	157,540	39,385	6,840,084	
39	Farmington Casualty Company	-	465	46,536	Yes
40	Federated Life Insurance Company	-	25,414	2,541,431	Yes
41	Federated Mutual Insurance Company	2,865,642	227,597	22,759,673	Yes
42	Federated Rural Electric Insurance Corp.	2,461,479	19,917	1,991,676	Yes
43	Federated Service Insurance Company	-	599	1,991,676	
44	Fidelity & Casualty Company of New York	77,293	4,617	461,655	Yes
45	First Liberty Insurance Corporation	135,216	8,745	874,484	Yes
46	Fortis Benefits Insurance Company	771,980	180,751	18,075,142	Yes
47	Fortis Insurance Company	87,841	21,960	11,257,611	
48	Geico Casualty Company	-	26,316	26,452,017	Yes
49	Geico General Insurance Corporation	-	31,484	3,148,363	Yes
50	General Casualty Company of Illinois	1,573,426	1,727	1,726,962	Yes
51	Government Employers' Insurance Company	-	40,932	4,093,238	Yes
52	Graphic Arts Mutual Insurance Company	-	31,440	3,143,983	Yes
53	Great American Insurance Company	936,953	19,535	1,953,455	Yes
54	Great West Life & Annuity Insurance Comp.	6,309,920	264,520	26,452,017	Yes
55	Hartford Casualty Insurance Company	1,032,681	75,800	7,579,976	Yes
56	Hartford Steam Boiler & Inspection Insurance Company	480,315	31,911	3,191,146	Yes
57	Hartford Underwriters	1,505,907	110,535	11,053,502	Yes
58	Insurance Company of North America	3,345,880	9,336	933,647	Yes
59	Liberty Insurance Corporation	992,885	63,039	6,303,901	Yes
60	Liberty Mutual Fire Insurance	4,155,605	269,453	26,945,299	Yes

Companies Claiming Salary Credit - Tax Year 1998

	COMPANY	SALARY BASE	SALARY CREDIT	Taxable Premiums	1.0 % Cap
61	Liberty Mutual Insurance Company	440,649	28,490	2,849,024	Yes
62	Life Insurance Company of North America	112,889	60,733	6,073,323	Yes
63	Life Insurance Company of Virginia	-	10,211	1,021,085	Yes
64	LM Insurance Corporation	290,490	18,776	1,877,576	Yes
65	Lumberman's Mutual Casualty	10,064,183	41,928	4,192,849	Yes
66	Maryland Casualty Company	291,831	19,715	1,971,545	Yes
67	Metropolitan Life Insurance Company	4,369,534	417,544	41,754,425	Yes
68	Mid-Century Insurance Company	-	220,773	22,077,287	Yes
69	Mony Life Insurance Company	1,539,351	73,985	7,398,476	Yes
70	National Benefit Life Insurance Company	-	2,422	242,214	Yes
71	National Fire Insurance Company of Hartford	186,024	11,111	1,111,079	Yes
72	National Indemnity Company	-	5,937	593,686	Yes
73	National Life Insurance Company	52,439	13,110	2,027,700	
74	New England Life Insurance Company	1,632,392	174,073	17,407,316	Yes
75	New York Life Insurance Company	1,932,480	483,120	53,785,303	
76	Niagara Fire Insurance Company	252	15	1,506	Yes
77	North River Insurance Company	-	27,745	2,774,524	Yes
78	Northern Insurance Company of New York	597,012	40,333	4,033,279	Yes
79	Ohio Casualty Insurance Company	1,067,885	42,119	4,211,897	Yes
80	Ohio Security Insurance Company	1,067,885	409	40,929	Yes
81	Pharmacists Mutual Insurance Company	69,048	16,358	1,635,797	Yes
82	Phoenix Insurance Company	2,749,362	34,196	11,081,428	
83	Primerica Life Insurance Company	19,826	127,459	12,745,873	Yes
84	Principal Life Insurance Company	4,130,128	401,834	40,183,409	Yes
85	Property & Casualty Insurance Company of Hartford	551	40	4,046	Yes
86	Republic-Franklin Insurance Company	-	6,602	660,228	Yes
87	Royal Maccabees Life Insurance Company	121,549	19,958	1,995,840	Yes
88	Safeco National Insurance Company	27,007	6,752	900,863	
89	Sentry Life Insurance Company	-	3,278	327,757	Yes
90	Shelter Mutual Insurance Company	3,712,388	337,434	33,743,431	Yes
91	Standard Fire Insurance Company	-	10,900	1,090,035	Yes
92	State Farm Fire & Casualty Company	5,738,937	1,288,899	128,889,917	Yes
93	State Farm Mutual Automobile Insurance	15,954,487	2,400,741	240,074,066	Yes

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Companies Claiming Salary Credit - Tax Year 1998

	COMPANY	SALARY BASE	SALARY CREDIT	Taxable Premiums	1.0 % Cap
94	Standard Insurance Company	290,158	41,024	4,102,449	Yes
95	Traders Insurance Company	8,000	2,000	2,942,800	
96	Transcontinental Insurance Company	1,564,642	93,014	9,301,430	Yes
97	Transportation Insurance Company	2,976,913	173,085	17,308,467	Yes
98	Travelers Casualty & Surety Company	-	14,947	1,494,689	Yes
99	Travelers Casualty & Surety Company of America	-	10,239	1,023,936	Yes
100	Travelers Casualty Company of Connecticut	-	186	18,600	Yes
101	Travelers Indemnity Company	7,938,781	80,573	8,057,299	Yes
102	Travelers Indemnity Company of America	-	46,941	4,694,109	Yes
103	Travelers Indemnity Company of Connecticut	-	16,077	1,607,739	Yes
104	Travelers Indemnity Company of Illinois	-	170,237	17,032,735	Yes
105	Travelers Insurance Company (Casualty Dept)	-	71,489	7,148,907	Yes
106	Travelers Insurance Company	139,349	55,483	5,548,264	Yes
107	Travelers Life & Annuity Company	-	930	93,017	Yes
108	Triton Insurance Company	-	20,585	2,058,456	Yes
109	Truck Insurance Exchange	-	28,529	2,852,876	Yes
110	Twin City Fire Insurance Company	1,110,714	81,527	8,152,748	Yes
111	Unicare Life & Health Insurance Company	23,010	5,752	3,594,039	
112	Unified Life Insurance Company	468,704	996	99,610	Yes
113	Union Central Life Insurance Company	132,479	32,668	3,266,813	Yes
114	Union Insurance Company of Providence	-	54,646	5,464,633	Yes
115	United States Fidelity & Guaranty Company	1,814,245	55,473	5,147,294	Yes
116	United States Fire Insurance Company	2,354,168	103,169	10,316,870	Yes
117	Unum Life Insurance Company of America	2,691,628	170,130	17,012,974	Yes
118	Utica National Assurance Company	-	135,155	13,515,496	Yes
119	Valiant Insurance Company	156,226	10,554	1,055,428	Yes
120	Valley Forge Insurance Company	606,801	36,084	3,608,358	Yes
121	Valley Forge Life Insurance Company	1,233,467	63,157	6,315,659	Yes
122	West American Insurance Company	-	116,435	11,625,197	Yes
123	Western Surety Company	417,969	12,862	1,286,183	Yes
		$251,519,553	**$12,223,877**	**$1,329,637,140**	

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Companies Claiming Salary Credit - Tax Year 1998

	COMPANY	SALARY BASE	SALARY CREDIT	Taxable Premiums	1.0 % Cap
	DOMESTIC COMPANIES				
124	Armed Forces Insurance Exchange	4,046,105	15,659	1,565,872	Yes
125	American Home Life Insurance Company	1,422,833	28,970	2,897,036	Yes
126	Blue Cross & Blue Shield of Kansas, INC	67,654,254	5,369,967	536,996,681	Yes
127	Bremen Farmers Mutual Insurance	413,802	110,302	11,030,212	Yes
128	Delta Dental Plan of Kansas	1,164,838	148,527	14,852,765	Yes
129	Farm Bureau Mutual Insurance Co. Inc.	14,222,239	1,682,831	182,915,388	
130	Farmers Alliance Mutual Insurance Co.	9,841,730	353,084	44,022,481	
131	Farmers Mutual Insurance Co.	167,402	22,623	2,127,766	Yes
132	Kansas Farm Bureau Life Insurance Company	2,372,844	260,400	26,039,962	Yes
133	Kansas Medical Mutual Insurance Co.	1,288,353	101,915	10,191,473	Yes
134	Marysville Mutual Insurance Co.	277,248	48,176	11,452,567	
135	Upland Mutual Insurance, Inc.	418,548	114,526	9,017,085	
136	Benchmark Insurance Company	465,570	90,171	8,829,779	
137	Columbian National Title Insurance Co.	1,355,294	80,936	3,578,851	
138	Farmers Insurance Company, Inc.	-	1,656,457	165,645,695	Yes
139	Heartland Health, Inc.	886,719	156,533	15,653,296	Yes
140	Kansas Bankers Surety Company	915,040	34,081	3,408,098	Yes
141	KFB Insurance Company, Inc.	672,480	44,526	4,452,590	Yes
142	Patrons Insurance Company	864,174	150,788	15,078,831	Yes
143	Plains Insurance Company	-	117	18,777	Yes
144	Pref. Health Systems Insurance Company	763,630	84,083	8,408,292	Yes
145	Pyramid Life Insurance Company	3,951,339	9,553	955,339	Yes
146	Security Benefit Life Insurance Company	21,845,828	82,595	8,259,525	Yes
147	Kansas Mutual Insurance Co.	277,248	48,176	4,817,553	Yes
148	Travel Air Insurance Company (KS)	235,796	81,540	8,154,000	Yes
149	Universal Underwriters Insurance Company	43,421,060	90,038	9,003,779	Yes
	SUB-TOTAL	**$178,944,374**	**$10,866,574**	**$1,109,373,693**	
	TOTAL	**$430,463,926**	**$23,090,452**	**$2,439,010,833**	

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Memorandum

To: Duane Goossen, Director of the Budget

From: Kathleen Sebelius, Commissioner of Insurance

Date: 12/23/99

Re: Options to Existing Premium Tax Provisions

I promised that I would provide to you some options to mitigate the loss in premium tax revenues. In an informational memorandum that I sent to you in September, I outlined some major reasons for the FY 1999 decline in premium tax income to the state. The primary reason for the approximately $20 million dip in premium tax receipts is attributable to a job credit available to insurance companies that employ Kansas residents. This credit, first effective with tax year 1998, serves two purposes. (1) To "hold harmless" domestic companies that would now pay an increased rate from 1.0 percent to 2.0 percent on taxable premiums written. The domestic companies could use the credit to reduce their tax liability back to the 1.0 percent. (2) To increase the marketability of the State of Kansas in attracting new jobs and retaining current jobs.

How the job credit works: For tax year 1998, companies were allowed to reduce their premium tax liability by an amount that represented **25.0 percent** of salaries paid to Kansas employees. The amount of salary credit cannot exceed 1.0 percent of taxable premiums.

For tax year 1999 and subsequent tax years, insurance companies are allowed to take a credit against their premium tax liability for up to **30.0 percent** of salaries paid to Kansas employees. The amount of salary credit cannot exceed 1.25 percent of the total premium tax liability.

Note: On the attached table, the amounts shown for FY 1999 are actual dollars and reflect the provisions that were in effect for tax year 1998. The provisions for tax year 1999 are expected to further decrease premium tax receipts.

Some options to consider:

To prevent further losses in premium tax revenues:

- Retain provisions that pertain to tax year 1998. This would roll back to 25.0 percent the amount of salaries paid to Kansas employees that could be used as a credit. Fiscal effect: approximately $1.0 million per one percent.

- Keep in place the 1998 tax cap of 1.0 percent. (As mentioned on the previous page, current law will increase this cap to 1.25 percent for tax year 1999 and subsequent years.) Every roll back of one-quarter of one percent has the potential to increase revenues by approximately $6.25 million.

To increase premium tax revenues above current projections:

- Increase the current 2.0 percent premium tax rate. Fiscal effect: $8.6 million per one-quarter of one percent. (Missouri is at 2.0 percent, Nebraska at 1.0 percent, Oklahoma at 2.25 percent, Iowa at 2.0 percent, Colorado at 2.05 percent.)

- Currently companies may allocate their salary credit among insurance company affiliates. As an example, three affiliated companies had more than $8.0 million in Kansas employees' salaries. The 1.0 percent cap, based on the companies' premium tax liability meant that the three companies could collectively take only a $120,000 salary credit. The companies then allocated the remaining portion of the $8.0 million in salaries to 25 or more affiliated companies (none of whom previously had Kansas employees' salaries). Those affiliated companies were able to take $680,000 in additional salary credits against their premium tax liability.

  The language that permits this allocation could be repealed.

- Reduce the existing caps below 1998 percentages. (See above for fiscal effect.)

Premium Tax
Review
Kansas Insurance Department

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	FY 1997	FY 1998	FY 1999	
Privilege Tax	$1,001,198	$2,112,535	(1,191,386)	1
Foreign and Domestic Premium Tax	78,664,361	84,909,825	64,306,261	2
	4.74%	7.94%	-24.27%	
(Decline in dollar amount.)			(20,603,564)	
Fire Marshal Tax	197,656	200,000	200,000	
Retaliatory Tax	1,656,382	2,996,667	2,787,877	
TOTAL PREMIUM TAX	$81,519,597	$90,219,027	$66,102,752	
Fines and Penalties	767,625	440,515	410,764	
Total	$82,287,222	$90,659,542	$ 66,513,515	

1 HB 2082 eliminated the privilege tax beginning with tax year 1998.

2 Reduction reflects a new job credit (loss of $14.3 in foreign tax receipts, small business credit (loss of $1.06 million), repeal of tax on annuity income ($1.0 million), and larger credits taken in tax year 1998 for guarantee assessments ($2.0 million).

Memorandum

To: Duane Goossen, Director of the Budget

From: Kathleen Sebelius, Insurance Commissioner

Date: September 7, 1999

Re: Premium Tax Receipts – FY 1999

Under existing tax statutes, domestic and foreign premium tax collections for FY 1999 were $20.8 million lower than the $88.1 million collected in FY 1998. While April estimates indicated that there would be a shortfall, those estimates of $78.0 million still proved too ambitious. Under the current statutory structure, we will no longer see the $80-$90 million collected in previous fiscal years.

	FY 1998	FY 1999
Foreign Premium Tax Receipts	74,485,227	57,866,384
Domestic Premium Tax Receipts	10,424,598	6,439,877
State Fire Marshal (SGF Transfer)	200,000	200,000
Retaliatory Taxes	2,996,666	2,787,877
PREMIUM TAX TOTAL	**88,106,491**	**67,294,138**
Domestic Co. Income (Privilege)	2,112,535	(1,191,386)
TOTAL	90,219,026	66,102,752

BACKGROUND Shortly after I became Insurance Commissioner, in 1995, I became aware of an issue that was related to premium tax payments by insurance companies. Historically, the State of Kansas, like the majority of states, imposed a premium tax on those companies conducting business within its borders. Kansas tax rates differentiated between foreign and domestic companies, by charging a 2.0 percent rate to foreign companies and a 1.0 percent rate to domestic companies.

In 1985, the United States Supreme Court held in *Metropolitan Life Insurance Co. v. Ward*, that Alabama's practice of taxing foreign and domestic companies at different rates constituted a violation of the Equal Protection Clause of the United States Constitution, and was invalid. Alabama subsequently passed legislation that increased taxes of the domestic industry and set a flat tax rate of 2.3 percent. Other states that provided preferential premium tax rates to domestic insurance companies were also sued, and LOST the court challenges. In spite of the clear judicial rulings from the United States Supreme Court and various circuit court jurisdictions, the Kansas law continued to allow a differential tax rate.

Many of the premium tax payments that came into the Department after 1985 were accompanied by "Letters of Protest." Foreign companies were protesting the inequality of the tax rate. The threat of litigation related to this issue was significant motivation for the review of our tax statutes, since a ruling that might require us to retroactively reduce the tax rate to 1.0 percent could cost the state more than $500 million.

In February of 1996, I designated a group of individuals in the Department to review insurance taxes and fees and make recommendations for presentation to the 1997 Legislature. This group evaluated the current tax structure in relation to other states' and proposed changes where they seemed needed.

HB 2082 – EQUALIZATION OF THE PREMIUM TAX RATE

HB 2082, presented to the 1998 Legislature, contained provisions that addressed this disparity in premium tax rates. The bill increased the premium tax on Kansas insurance companies from 1.0 percent to 2.0 percent, thus removing the preference for domestic companies. In order to "hold harmless" the Kansas domestic insurers, and to meet the standards set out by the courts for tax reductions, the Legislature approved a salary credit formula, which would rebate premium taxes to ANY company, foreign or domestic, with jobs in Kansas. This mechanism was projected to allow domestic insurers to reduce their taxes back to the 1% level (revenue neutral), and provided new tax credits for all foreign companies with Kansas employees. Legislators hoped that the new tax credit would serve as an economic development incentive to move more insurance jobs to our state. Finally, the bill also removed the premium tax on annuity sales, effective January 1, 1997, repealed the state's privilege tax on insurance companies, and allowed *all* insurers to participate in the Kansas Investment Tax Credit which allows a credit of 25.0 percent of premium tax liability provided that 30.0 percent of a company's admitted assets are invested in Kansas securities.

THE TAX PROCESS – KANSAS INSURANCE DEPARTMENT

Prepayment of Taxes Based on Previous Tax Year. Companies prepay their taxes each year. The prepayments are based on the companies' tax liability from the "previous" tax year. On March 1, companies submit their tax returns for actual tax liability. Insurance Department auditors review the tax statements of each company, and compare this actual tax liability to the amount that the company has prepaid. If

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a company's tax return indicates a lower liability that what the company has prepaid; the Insurance Department refunds the difference. If the company's return indicates a liability that is more than what the company has prepaid, the company is billed for the difference.

Refunds) The Department processed $21.2 million in refunds in FY 1999. This contrasts sharply with FY 1998, when approximately $8.1 million in refunds was processed. There is a direct correlation between this high total in FY 1999 and the dollar amount in tax credits that companies took advantage of in tax year 1998. Prepaid taxes did not consider the large credits. Once the actual liability was considered, in many cases refunds were due back to the companies.

Employee Tax Credit
Tax auditors reviewed all company tax returns and compiled salary tax credits claimed by companies for tax year 1998. Staff looked at the files of approximately 30 large insurance companies, and compared their tax liability this year with last year's. (See the attached.) In many cases where the dollar amount of premiums written by the companies did not significantly change from 1997 to 1998, these companies took higher credits in 1998. This resulted in a significantly smaller tax bill for 1998 and larger refunds. In our sampling, those 30 companies alone paid $2.5 million less in premium taxes this year.

Summary. In summary, premiums were relatively stable between tax years 1997 and tax years 1998. Oher new credits that include the guaranty association credit; the regulation fund assessment credit and provisions that repealed the privilege tax and the tax on annuities negatively affect premium tax receipts. What appears to have had the single largest impact on tax receipts, however, is the job tax credit. We are, however, confident from an increase in activity in increasing the size of service centers and new offices opening in Kansas, that there is some financial boost resulting in relocation of jobs to Kansas.

We are unsure about the future impact of this credit. According to the law, companies will be able to claim larger employee tax credits next year. The law provides that the total percentage of Kansas residents' payroll that companies may claim for tax year 1998, will increase from 25.0 percent to 30.0 percent for subsequent years. The 1.0 percent cap (against premium tax liability) for this credit will also be raised to 1.25 per cent for subsequent tax years. If premiums remain relatively flat, we could see even lower receipts in FY 2000. (KSA 40-252d) Other provisions of the law that repealed the tax on annuities, guarantee companies, and the repeal of the privilege tax had a negative effect on premium tax receipts.

POLSINELLI
WHITE
VARDEMAN &
SHALTON

Memorandum

TO: The Honorable Audrey Langworthy, Chair
Senate Assessment & Taxation Committee

FROM: William W. Sneed
Polsinelli, White, Vardeman & Shalton, P.C.

RE: Kansas Insurance Premium Tax Receipts

DATE: March 15, 2000

Madam Chair, Members of the Committee: My name is Bill Sneed and I am an attorney with the law firm of Polsinelli, White, Vardeman & Shalton, P.C. As many of you know, I represent numerous insurance companies, both foreign and domestic, on a variety of legislative and traditional legal issues. You are also aware that, based upon discussions with the Director of Budget, the Kansas Insurance Commissioner and the Chairman of the Senate Financial Institutions and Insurance Committee, an issue has come up relative to the 1997 legislative changes dealing with insurance premium tax. At the request of the Chairman of the Senate Financial Institutions and Insurance Committee, I, along with other representatives of the insurance industry, have been reviewing the various documents produced by Budget and the Insurance Department. The Chairman asked that we review these numbers so as to get a perspective from industry as to the effects of the 1997 change relative to what appears to be a substantial decrease in premium taxes collected.

Although others may touch upon the historical basis of the change, I feel it necessary to briefly give some background to the Committee before entering into my discussion on our limited analysis of the affect of the premium tax changes.

In 1985, the United States Supreme Court in *Metropolitan Life Insurance Co. v. Ward* held that a tax differential between domestic and foreign insurance companies imposed by the State of Alabama was unconstitutional. Thereafter, and over subsequent years, a number of state supreme courts also invalidated state premium tax statutes because they taxed domestic and foreign companies at different rates. The then-current Kansas law imposed a 2% premium tax on foreign companies and a 1% tax on domestic companies. As you can tell, there was a great deal of judicial authority to indicate that Kansas law was unconstitutional.

Since the *Metropolitan* case, a substantial number of foreign insureds began paying their premium taxes to Kansas under protest. At the time 1997 H.B. 2082 was introduced, the Kansas

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Senate Assessment + Taxation
3-16-00 Attachment 2

Insurance Department estimated that the State of Kansas had a potential contingent liability of approximately $500,000,000.00.

Prior to the introduction of 1997 H.B. 2082, members of the industry and the Kansas Insurance Department began working on a proposal to submit to the legislature. Although simple in theory, i.e., eliminating the differential, the balancing act between various interests was very complex. Obviously, the State of Kansas had a contingent liability that it wished to eliminate. However, the parties were concerned as to how receptive a legislative response would be to simply increasing the domestics from 1% to 2%. Further, the legislature and the Insurance Department were concerned relative to the domestic industry inasmuch as it could be harmed by such a tax increase. The other side of the coin was what fiscal affect the state would incur by reducing foreign insurers from 2% to 1%. After much work, the proposal was submitted by the Kansas Insurance Department to the 1997 Legislature in the form of H.B. 2082. As many will remember, the House substantially changed the original proposal and in essence reduced foreign companies from 2% to 1%. The Senate then did a substitute bill which in essence was ratified by the Legislature and enacted into law.

As discussed with the 1997 Legislature, the bill generally did the following:

1. increased the overall tax rate for domestic insurers from 1% to 2%;

2. created a new salary tax credit available to <u>all</u> insurers that was capped for tax year 1998 to 25% of salaries paid to Kansas employees, or 1% of taxable premiums, whichever was less, and for tax year 1999 and subsequent tax years a credit of up to 30% of salaries paid to Kansas employees, not to exceed 1.25% of total tax premium liability;

3. repealed the privilege tax which was paid by the domestic industry;

4. repealed the tax on annuity products;

5. allowed foreign insurers to take the firefighters' relief tax credit which was already available to domestic insurers; and

6. repealed the Kansas investment tax credit, which was only available to the domestic industry.

Again, in general terms, the idea was to minimize the fiscal affect on the state general revenue funds, but at the same time create a tax system that would in essence hold harmless the domestic industry on its effective tax rate. In other words, they would be required to pay at a 2% tax level, but have available to them tax credits that could get their effective tax rate back down to 1%. Obviously, foreign insurers that were eligible for the tax credits would get the same treatment as the domestics, and as such there would be a reduction in overall tax receipts to the state. However, the Legislature, when reviewing this proposal, decided that on balance ($500,000,000.00 in contingent liability versus a certain tax revenue reduction over time) this seemed to be the most prudent approach to resolving this problem.

The first evidence of the effect of 1997 H.B. 2082 was demonstrated during the fiscal 1999 tax collection, which was based on premiums written for calendar year 1998. According to the material provided to us by the Kansas Insurance Department, tax receipts from fiscal year 1998 to fiscal year 1999 went from $90,659,542.00 to $66,513,515.00. This, along with other tax receipt shortfalls that became evident in late 1999, started the discussion on this particular issue.

The question then arises as to what happened. However, before addressing the question, one needs to look at why the question is asked. That is important because although there was acknowledgement that there would be a reduction in tax revenues, the Department of Insurance and Budget were surprised by the extent of the reduction. The basis for that "surprise" can be tied back to the estimates that were utilized by the 1997 Legislature. Although there were numerous flow charts and comparison charts floating around during this debate, I have attached to my testimony what I believe to be the comparison chart that was utilized when a final decision to approve 1997 H.B. 2082 was made.

In essence, the Legislature, along with all interested parties, had the good faith belief that the fiscal impact of the bill that was ultimately passed would be somewhere between $11,000,000.00 and $12,000,000,000.00 in its first year. Thus, when faced with an approximate $24,000,000.00 decrease you can revert back to my original question, that is, what happened?

Simply put, what happened was that the law worked, and for a variety of reasons the estimates made in 1997 did not necessarily hold true. Based upon our working group's review of the situation, we have come away with the following perspective.

1. Privilege tax. During fiscal year 1999, a refund of just over a million dollars on privilege tax was made. Although it is possible that there may be an additional refund in fiscal year 2000, this is most likely a one-time aberration, and thus $1,000,000.00 of the shortfall can be attributed to that issue.

2. Privilege tax, annuity tax, firefighters' relief credit, and Kansas investment tax credit. It would appear that within a reasonable degree the estimates made in 1997 were fairly close to the actual effect as demonstrated in the estimates made in 1997.

3. Salary tax credit. As demonstrated in the comparison chart attached to my testimony, it was estimated that the Senate proposal on salary tax credit was just over $7,000,000.00. My file reflects that this number is attributable to the decrease as it relates to foreign insurers inasmuch as in theory the salary tax credit for domestics would be a wash vis-à-vis its increase to a 2% tax rate. It would appear that the salary tax credit taken and reflected in fiscal year 1999 numbers was just over $12,000,000.00, which would result in an underestimate of just over $5,000,000.00.

4. Other tax consequences not included in 1997 estimates. Our review indicates there were three major components that for whatever reason were not plugged into the 1997 tax analysis when reviewing 1997 H.B. 2082. Two of the three most likely were not considered because it would have been difficult, if not impossible, to come up with an estimate due to its volatile nature. Those two are guaranty fund

assessment tax credits and other corporate tax changes. The third item was premium growth. Our review has indicated the following:

(a) other corporate tax changes. These were changes in the Kansas tax code which affected all Kansas corporations. Our general review has indicated to us (and probably can only be categorized as a guess) that this had a $2,000,000.00 reduction as it relates to Kansas insurance companies; and

(b) credits for guaranty fund assessments were again not included in the calculations. Ironically, in fiscal year 1999 the effect of a large, life insurance guaranty fund assessment was reflected by larger than usual guaranty fund tax credits. It appears (and again, this is our best guess) that this had an additional $2,000,000.00 reduction affect not included in the original estimates in 1997; and

(c) growth estimates. In 1997 estimates were made on the growth of insurance premiums in the out years so as to base the estimates on premium tax revenue. Based upon my records as compared to actual premiums written, it would appear that the growth estimates for fiscal year 1999 were overestimated, and as such resulted in a $2,000,000.00 reduction that was not put into place during the 1997 review.

The second chart attached to this testimony provides in summary form the math on the numbers provided above. When looking at all of the components, it is obvious that had we known in 1997 the information we now have, there would not have been much of a surprise concerning the tax receipts collected for fiscal year 1999.

It is my hope that this information will provide some guidance as the Committee reviews this issue. We appreciate the opportunity to testify and will be happy to answer questions.

Respectfully submitted,

William W. Sneed

WWS:kjb
Attachments

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Comparison of Tax Bill Provisions

Provisions:	**HB 2082**	**House Version**	**Senate Proposal**
Premium Tax	2%	1%	2%
Salary Credit	25%	1/4%	25% + 1/4%
Privilege Tax	Repeal	Repeal	Repeal
Annuity Tax	Repeal	Repeal	Repeal
Firefighters Credit	Domestics	Domestics & Foreign	Domestics & Foreign
Investment Tax Credit	Domestics & Foreign	Repeal	Repeal

Comparison of Fiscal Impact

Provisions:	**HB 2082**	**House Version**	**Senate Proposal**
Premium Tax & Salary Credit	($3,700,000)	($22,000,000)	($7,100,000)
Repeal Privilege Tax	($1,000,000)	($1,000,000)	($1,000,000)
Repeal Annuity Tax	($1,500,000)	($1,500,000)	($1,500,000)
Give Firefighters Credit To Foreign Insurers	- 0 -	($3,500,000)	($3,500,000)
Repeal Kansas Investment Tax Credit	- 0 -	$2,000,000	$2,000,000
Total Fiscal Impact	($6,200,000)	($26,000,000)	($11,100,000)

Kansas Insurance Department (3/25/97)

FY 1998 Tax Receipts	$90 million
FY 1999 Tax Receipts	$66 million

Differential	$24 million
1997 estimated reduction	$11 million

Differential	$13 million
1997 previous tax refund	<$1 million>
Foreign company salary tax underestimation	<$5.1 million>
Other state tax reductions	<$2 million>
Guaranty fund tax credit	<$2 million>
Premium growth reduction	<$2 million>
Difference	<.9 million>