

SUBJECT: Flat premium tax rates and the retaliatory premium tax law

COMMITTEE: Insurance — committee substitute recommended

VOTE: 9 ayes — Smithee, Eiland, Burnam, G. Lewis, J. Moreno, Olivo, Seaman, Thompson, Wise

0 nays

WITNESSES: For — Alison Evers, Stewart Title Guaranty Company; Richard Geiger, Association of Fire and Casualty Companies in Texas; Mike Pollard, Texas Association of Life and Health Insurers; Forrest Roan, American Insurance Association

Against — None

On — Will D. Davis, Texas Association of Life and Health Insurers

BACKGROUND: The Texas Insurance Code uses a graduated system to determine the tax rate for property and casualty insurance companies and title insurance companies.

The basic premium tax rate for property and casualty companies is 3.5 percent. Property and casualty companies may qualify for a premium tax rate of 2.4 percent if they owned Texas investments in the previous calendar year equal to 85 percent-to-90 percent of the investments owned in the state where the company owns the most investments. The premium tax rate falls to 1.6 percent if the company owns Texas investments equal to more than 90 percent of the investments owned in the state where the company owns the most investments.

For title insurance companies, the basic premium tax rate is 2 percent which drops to 1.3 percent if the company owned Texas investments equal to more than 90 percent of the investments owned in the state where the company owns the most investments.

The Texas Insurance Code requires the comptroller to impose the same taxes, licenses, fees, fines, penalties, deposit requirements, or other obligations, prohibitions or restrictions on out-of-state insurance companies if they are

from states imposing those conditions on Texas companies. Essentially, the comptroller can treat out-of-state insurance companies the same way that their home state treats Texas insurance companies.

DIGEST:

CSHB 1837 would eliminate the tiered premium tax system for property and casualty insurance companies and title insurance companies. Both types of companies would be taxed at a flat rate. Property and casualty insurers would have a premium tax rate of 1.6 percent, while title insurance companies would have a premium tax rate of 1.35 percent. No lower rates would be provided for investing in Texas.

CSHB 1837 also would revise the retaliatory tax statute. The comptroller could apply a retaliatory tax to an insurance company from a state where no Texas insurance company currently operates, but could theoretically operate.

CSHB 1837 would replace the long list of fees, restrictions, and prohibitions imposed by other states for which Texas could retaliate with the phrase “mandatory provisions.” The definition of “mandatory provisions” would include the existing list, plus “guaranty funds and assessments net of recoupments or tax credits,” to the conditions that would trigger retaliatory action.

CSHB 1837 would empower the comptroller to adopt procedures for comparing the highest aggregate tax rates between Texas and other states.

The changes made by CSHB 1837 to laws other than the retaliatory tax statute would apply only to a premium tax imposed under Articles 4.10 and 9.59 of the Insurance Code beginning with the tax year that begins January 1, 2000.

**SUPPORTERS
SAY:**

Currently, 95 percent of Texas insurance companies and 89 percent of out-of-state insurance companies qualify for the lowest rates under the tiered premium tax system. Since most companies already qualify for the lowest rates, there is no longer a real need for the archaic tiered system.

The tiered premium tax system used by Texas makes it more difficult to impose retaliatory taxes on out-of-state companies while making it easier for other states to impose retaliatory taxes on Texas companies. Retaliatory taxes are calculated using the basic tax rates of 3.5 percent and 2 percent.

Therefore, Texas and its insurance companies are treated as though Texas imposes a high tax rate even though the actual rate for most companies is very low. With a low basic rate, more out-of-state companies would have to pay retaliatory taxes since the basic rate in many other states is around 2 percent for property and casualty companies. At the same time, a low basic rate would protect Texas companies from the retaliatory taxes imposed by other states.

Both Texas and out-of-state insurance companies agree that the current system is too complex and should be changed to a flat rate. These companies also agree that the current lowest rate for premium taxes is the appropriate level for a flat tax.

The tiered system does not encourage prudent investment in Texas. Some companies ignore Texas investment requirements until the end of the calendar year, then invest only to qualify for the lower premium tax rates. Computerized portfolio systems allow companies to qualify for the lower rate with the touch of a button. For the many insurance companies that choose to invest in Texas securities because they are good investments, this sound investment strategy would not change under CSHB 1837.

CSHB 1837 is not protectionist because it only would impose retaliatory taxes on out-of-state companies to the degree that their home states tax Texas companies. Retaliatory taxes actually encourage the free market by giving incentives for states to adopt the same premium tax rate. The Texas economy will bring out-of-state insurance companies to Texas even if there is a higher retaliatory tax burden.

The provision for applying retaliatory taxes to companies from states where a Texas company “might theoretically be licensed” is necessary since the tax rate between similar types of companies would be used to calculate retaliatory taxes. While Texas insurance companies do operate in every state, certain types of out-of-state insurance companies that operate in Texas may not have equivalent Texas companies operating in their home state. The tax rate for an insurance company in another state is known even if there is no company actually paying the tax at the time.

Using the basic rate to calculate retaliatory taxes would allow for the same easy calculations that the flat tax provides. It is very difficult to determine the

actual effective premium tax rate in other states that still have complicated tiered tax systems or other variable rates.

OPPONENTS
SAY:

Retaliatory taxes against out-of-state insurance companies are protectionist and should be eliminated. They discourage the free market by imposing higher premium taxes on out-of-state insurance companies. Some out-of-state companies may not locate in Texas if the retaliatory tax is too high.

OTHER
OPPONENTS
SAY:

The provision in HB 1837 that would allow the comptroller to impose retaliatory taxes on companies from states where a Texas insurance company “might theoretically be licensed” is an unnecessary reach. Currently, there is at least one Texas insurance company in every state. The use of such overly broad language is simply not required.

While some states do use the basic rate to determine retaliatory taxes, the Texas Insurance Code has never specified whether the basic rate or the effective rate should be used. The effective rate, the tax rate that actually is imposed on an insurance company, should be used to determine the retaliatory tax.

NOTES:

The original bill the sections which would have applied to life, accident, and health insurers. The committee substitute changed the flat premium tax rate for property and casualty insurers from 1.725 percent to 1.6 percent.