Fiscal Note & Local Impact Statement

122 nd General Assembly of Ohio

BILL: **H.B. 370** DATE: **April 22, 1997**

STATUS: **As Introduced** SPONSOR: **Rep. Batchelder**

LOCAL IMPACT STATEMENT REQUIRED: **No**

CONTENTS: **Permits a mutual insurance company to reorganize as a stock insurance company**

State Fiscal Highlights

STATE FUND	FY 1997	FY 1998	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	Indeterminate effect	Indeterminate effect
Expenditures	- 0 -	- 0 -	- 0 -

- Any regulatory costs would be billable to the insurance companies desiring to reorganize under the provisions of the bill.
- Premium taxes could possibly decrease while corporate taxes would likely increase, resulting in an indeterminate effect.
- Corporate filing fees would increase in relation to the number of new holding companies created.

Local Fiscal Highlights

- No direct fiscal effect on political subdivisions.

Detailed Fiscal Analysis

Regulatory Costs

While the review of reorganization plans submitted to the Department of Insurance and the Attorney General's Office by mutual insurance companies desiring to reorganize in accordance with the provisions of the bill would likely generate costs, the bill provides for the billing of those costs to the insurance companies submitting the plans. In addition, any costs incurred by the Department of Insurance relating to the new holding companies created under the provisions of the bill (such as examinations and reviews) would again be billable to the insurer. Therefore, additional costs to the state are unlikely.

It should be noted that as with most legislation, rules would need to be adopted. The costs of writing and adopting those rules, however, would most likely be absorbed by the Department of Insurance.

Tax Implications

The transition from mutual to stock organization of Ohio insurance companies has differing state tax effects depending on whether current law is maintained or the changes in the current budget bill (HB 215) are adopted.

The analysis of different scenarios that follows is based on the premise that mutual life insurance companies tend to sell more participating policies than stock companies, which sell more nonparticipating policies. Participating policies carry higher annual premiums, but part of the premium is returned to policyholders each year.[1] Mutual companies selling life insurance thus tend to have slightly higher premiums, all other things equal (which is a big assumption).

Under Current Law

Currently, domestic insurance companies pay their state tax as the lesser of 0.6 percent on capital and surplus or 2.5 percent on gross premiums. A transition from mutual to stock company organization, without any other change, would tend to increase capital and surplus but decrease premiums. The net effect on insurance tax paid by domestic companies is therefore ambiguous.

Foreign insurers, however, pay a straight 2.5 percent premium tax. Thus, all other things being constant, premiums and premium taxes from foreign insurers may go down, subject to the caution that the companies might try to keep their premiums constant, since policyholders might not be aware of the implications of structural change (see below).

Under Am. Sub. H.B. 215

The analysis of the impact on domestic companies differs for the transition period and the post-transition period. During the transition period, domestic insurers will pay a "blended" tax, partly on the old capital and surplus method, and partly under the proposed new 1.5 percent of gross premiums method. The result, as under current law, is ambiguous. The conversion from

[1] See Marci Castillo, "State Taxation of the Life Insurance Industry: The Effects of High Domestic and Retaliatory Taxes on Firm Growth," dissertation chapter, Massachusetts Institute of Technology, November 1996, pp. 13-14.

mutual to stock organization, all other things constant, will tend to increase the capital and surplus of the companies but to decrease the premiums. This acts to increase the tax paid under the old method but to increase the premium tax, so the impact on the total “blended” tax is unknown.

Once the transition is complete, domestic and foreign insurance companies will be taxed at a straight 1.5 percent of premiums. In that case, the impact of a change from mutual to stock organization, all other things constant, will be to reduce premiums and therefore reduce tax revenue. As noted above, the decrease in premiums may be slow, if companies seek to keep their premiums at prior levels. However, since the change from mutual to stock organization will also reduce dividends, mutual companies may have to reduce premiums in response in order to retain customers.

Corporate Taxes and Filing Fees

The bill essentially allows the creation of two companies where there used to be one. The new entity, the mutual insurance holding company, will presumably be taxed as a regular corporation, and pay filing fees to the Secretary of State. The state could thus realize additional tax revenue from these holding companies, although presumably most would take advantage of the provision in Ohio law that excludes net worth derived from insurance company ownership, as long as ownership equals or exceeds 80 percent. The net state revenue impact of the possible decrease in premium taxes and increase in franchise taxes is unknown.

The increase in filing fees should be a gain to the state GRF. The amount is unknown, since LBO has no basis for estimating the number of conversions that will actually occur.

❑ *LBO staff: Frederick Church, Senior Economist*
Chris Whistler, Economist