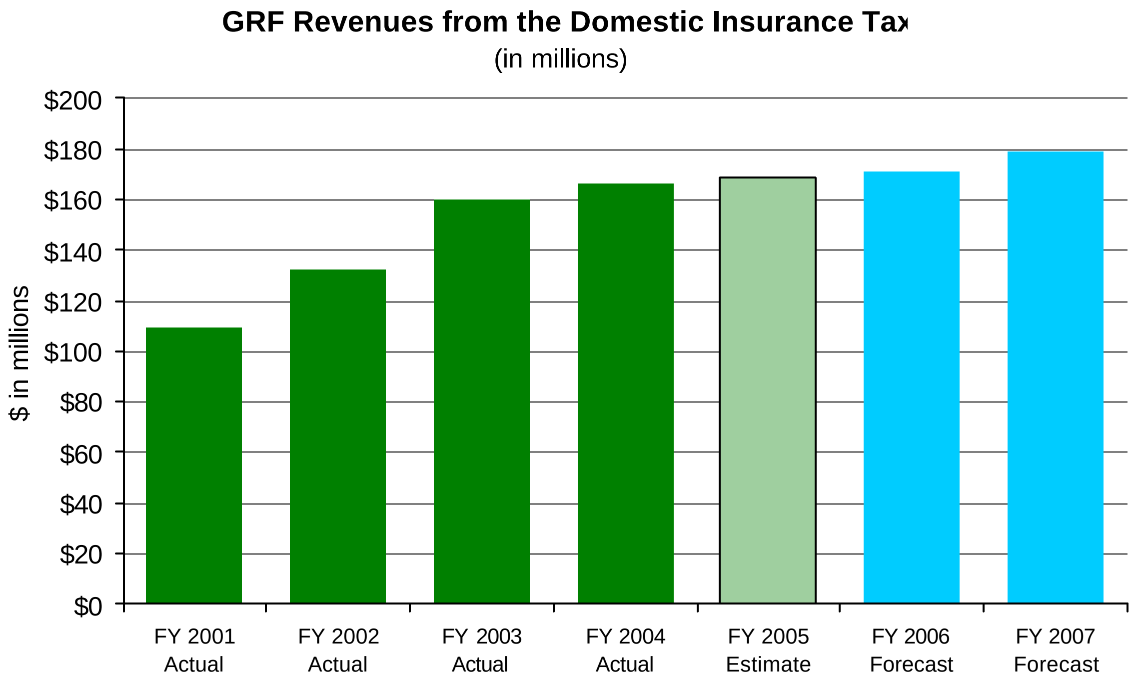
Domestic Insurance Tax



	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$109.3	$132.4	$160.1	$165.9	$168.4	$170.9	$179.0
Growth	24.0%	21.2%	20.9%	3.6%	1.5%	1.5%	4.7%

The domestic insurance tax is levied on premiums collected by insurance companies headquartered in Ohio. The tax is generally 1.4% of premiums; the primary exception is domestic insurance companies that are health insuring corporations (HICs) which pay 1.0% of premiums. This tax structure is the same as the current foreign insurance tax structure.

The current tax structure was created in Am. Sub. H.B. 215 of the 122nd General Assembly. The high rates of revenue growth shown in the table for fiscal years 2001, 2002, and 2003 were primarily due to those years phasing-in the new tax structure; FY 2003 was the first year for which the new structure was in place. Prior to the enactment of H.B. 215 this tax had a dual base: domestic insurance companies (other than HICs) paid the lower of a rate based on premiums collected or a rate based on their capital and surplus. While the tax rate was higher under the old structure, many companies paid the tax based on their capital and surplus because it yielded a lower tax liability. The result is that revenues under the tax increased rapidly during the phase-in of the new tax structure.[11] Because the tax changed from a dual base to a single base, revenue growth patterns before FY 2003 provide no useful guide to future revenue patterns.

Historical revenue patterns under the foreign insurance tax should provide a better guide to future revenue patterns under this tax, since the foreign insurance tax has had a tax base of premiums since it was established. The primary problem in using those patterns as a guide for this tax is that the breakdown of premiums collected by line of business differ significantly between domestic insurance companies and foreign insurance companies. For example, fire and casualty insurance premiums were the base for about 72% of the tax revenues certified for collection by the Superintendent of Insurance in May 2004 from domestic insurers, while that line of business contributed just 58% of the tax revenues certified for collection from foreign insurers.[12] Given the recent changes in the tax structure described above, however, the best approach to forecasting revenues under the domestic insurance tax is probably to introduce suitable modifications into the growth forecast for revenue from the foreign insurance tax.

As described further in the section on the foreign insurance tax, regression analysis of those revenues indicates that short-term interest rates are significant factors underlying revenue growth: higher interest rates yielding slower growth and lower interest rates yielding faster growth. Most economic forecasters are predicting that short-term interest rates will continue to rise in 2005 and 2006. Regression analysis of premiums collected by line of business indicate that life and health insurance premiums (which are more important to the foreign insurance tax) are more responsive to short term interest rates than fire and casualty premiums (which are relatively more important for this tax). Since interest rates are predicted to rise, this implies that the growth rate for the domestic insurance tax should be somewhat higher than that for the foreign insurance tax in FYs 2005 and 2006. Accordingly, growth in this tax is forecast to be 1.5% each year, compared to the 0.7% growth forecast each year for the foreign insurance tax.

In FY 2007 growth in revenue from the foreign insurance tax is projected to return to its long-term growth rate as increases in interest rates begin to moderate. Data compiled by the Ohio Department of Insurance on total premiums collected by line of business indicate that the long-term growth rates for premiums are higher for both HICs

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[11] Ohio companies that operate in other states may have realized a fall in their overall tax burden, however, as the higher rates paid to Ohio may have reduced their tax payments to some other states under the retaliatory tax many states, including Ohio, impose. The retaliatory tax is described in the **"*Foreign insurance tax*"** section.

[12] Domestic insurance companies also pay a higher proportion of their tax based on premiums collected by HICs. Foreign insurance companies pay a larger share of their taxes based on life and health insurance premiums.

(8.8% per year from 1979 to 2003) and life and health insurers (8.0%) than they are for fire and casualty insurers (6.8%). Averaging these growth rates appropriately[13] separately for each tax implies that the long-term growth rate for the domestic insurance tax would be lower than the long-term rate for the foreign insurance tax.

For the foreign insurance tax the forecast assumed a long-term growth rate of 5.01% per year, which was the average growth rate from FY 1992 to FY 2004 after adjusting for changes in tax rates. The adjustment derived from the differences in lines of business indicates that the long-term growth rate for domestic insurers would be slightly over 94% of the long-term rate for foreign insurers. Applying this adjustment factor to the 5.01% growth rate for foreign insurers yields a long-term growth rate for domestic insurers of 4.72%, which is the projected growth rate for revenues from this tax for FY 2007.

[13] Averaging the growth rates appropriately for each tax means taking a weighted average of the growth rates of premiums for each line of business, with the weights being the share that that line of business generates in tax revenue under each tax. The 6.8% growth for fire and casualty insurance premiums would, for example, have a weight of about 72% for the domestic insurance tax and a weight of about 58% for the foreign insurance tax.