

Fiscal Research Program

INSURANCE TAXATION IN GEORGIA : ANALYSIS AND OPTIONS

Martin F. Grace

**FRP Report No. 17
August 1998**



**Georgia State
University**

Andrew Young

School of Policy Studies

TABLE OF CONTENTS

	Page
Executive Summary	iv
Introduction	1
Size and Importance of the Insurance Industry to the State of Georgia	2
Criteria of Good Tax Policy	4
The Georgia Insurance Industry in Relation to the United States	6
Relationship Between Georgia and Tax Policy of Other States	12
History of Insurance Taxation in United States and Georgia	15
Structure of Georgia Premium Tax Law	20
Tax Base	20
Tax Rate	21
Tax Calculation	29
Retaliatory Tax	32
Exclusions from the Tax Rate	33
Fire and Surplus Lines Taxes	35
Alternative Taxes on Insurance: The Income Tax	36
Incidence of Income Tax	37
The Pros and Cons of Premium Taxation	38
Why Use a Premium Tax	38
Why States Should Not Use a Premium Tax	39
Examination of Georgia's Premium Tax	41
Empirical Evidence of the Incidence of Georgia's Premium Tax	41
Georgia Premium Tax Analysis	45
Economic Development: The Ideal Use of Tax Incentives	50
Conclusions and Potential Reforms	56
Equity	56
Neutrality	56
Elasticity and Stability	57
Economic Development	57
Obsolescence and Simplicity	58
Reform Options	59
References	62

EXECUTIVE SUMMARY

Like the great majority of states, Georgia uses a premium tax to tax its insurance industry. This premium tax raised approximately 2.08 percent of state taxes in 1997. In contrast, the Georgia Corporate Income tax generated 6.70 percent of state tax revenues in 1997.

The premium tax is one of the few taxes on services and its apparent low rate of 2.25 percent makes it appear innocuous. It is not likely that consumers even realize that the service is being taxed since the tax is collected by the insurer and passed along to the state, much like a sales tax. Two major advantages of the tax are that it is a simple tax and that revenue grows directly with income growth.

Although a relatively simple tax, Georgia provides a number of exemptions and abatements that make the tax more complicated. These abatements and deductions are provided for: investments in the state of Georgia; certain property-liability retaliatory taxes¹ paid to other states; local taxes and fees, and; accident and guarantee fund assessments. The exemptions for local taxes and fees and for the exemption for the guarantee fund assessments² are available to the life, accident and health insurance industries only.

Table A shows Georgia relative to important insurance states, as well as its sister southeastern states. Georgia appears to be in the middle to higher range in terms of tax rate for both the life and non-life insurance industries.

¹ Retaliatory taxes are those taxes imposed on a foreign company by a host state *because* the foreign company's own state levies a higher tax rate on premiums than the host state. Thus, when a company writes premiums in a state with a rate lower than its home state, that company essentially pays the higher rate of its own home state to the host state.

² Guarantee fund assessments are made against all companies doing business within Georgia if in the event of an insolvency, the assets of the insolvent company are not sufficient to pay the losses incurred. The assessment made by the Georgia guarantee fund is deductible against a company's premium tax.

Table A. Comparison of Georgia with Other Southeastern States
and Important Insurance States

State	Life Rate %	Non-Life Rate %	Effective Tax Rate%*	Non-Life NAIC Effective Rate %**
Alabama	2.80	3.6	3.35	3.65
Arkansas	2.50	2.5	1.84	3.11
California	2.35	2.35	2.07	2.44
Connecticut	1.75	2.00	2.29	2.64
Florida	1.75	1.75	1.70	3.08
Georgia	2.25	2.25	1.78	5.03
Illinois	2.00	2.00	.074	1.52
Kentucky	2.00	3.50	5.34	2.57
Louisiana	2.25	2.25	3.67	4.00
Massachusetts	2.00	2.28	2.59	2.38
Mississippi	3.00	3.00	2.87	3.16
New Jersey	2.10	2.10	1.49	1.93
New York	0.80	1.30	2.08	2.85
North Carolina	1.90	1.90	2.23	2.51
Ohio	2.50	2.50	2.17	1.60
South Carolina	0.75	1.25	1.38	3.59
Tennessee	2.00	2.50	2.26	2.65
Texas	2.40	3.50	2.41	2.41
Virginia	2.25	2.25	1.88	2.44

*Includes both life and non-life premium taxes, but only those taxes paid to the state.

**Obtained from Page 14 of the NAIC Annual Statement Tapes for the Poverty-Liability Industry.
Rate includes all taxes, licenses, and fees to state and local governments.

Georgia's effective rate appears to be much lower than most states. The effective tax rate is the total premium taxes collected by the state in 1994 divided by the total premiums written in 1994. Note that most statutory rates differ substantially from the effective rate. Georgia's nominal statutory rate is 2.25 percent, while its an effective rate is 1.78 percent. In contrast, Florida's nominal statutory rate is 1.75 and its effective rate is 1.70. These differences reflect differences in the structure of the states' tax laws. For Georgia this difference is due to credits and abateements available to certain companies doing business in Georgia.

The effective state tax rate shown in column (3), however, is not necessarily a good indicator of a tax burden since Georgia also has local premium taxes that are not included in the calculation of the effective tax rates. These local taxes are an additional 1 percent for life companies and an additional 2.5 percent for non-life companies. Further, the life companies can take a credit for their payments to local governments, while the non-life companies do not have a similar credit. The last column in Table A shows the effective tax rate for all non-life companies that write insurance in Georgia, and it includes *all taxes, licenses, and fees paid to Georgia or its political subdivisions*. (The third column reflects merely taxes collected by the state.) As can be seen, Georgia's non-life effective rate is significantly higher than the surrounding states.³ In fact, only one state has a higher effective tax rate for the non-life industry, Kentucky, which has substantial local taxes and fees in addition to the premium tax.

With the advent of competing financial services, combinations of providers could offer many insurance products. It is important not to provide a tax incentive for consumers to purchase from one provider over another. Currently in Georgia, banks are taxed in one way, insurers in another, and non-bank financial institutions in still another. For horizontal equity to be achieved, all financial service companies should be treated similarly for tax purposes.

Another part of the Georgia premium tax structure affecting horizontal equity (within the insurance industry) concerns the use of abatements and exemptions. One of the important abatements or exemptions is the investment abatement. It is supposed to facilitate economic growth and to reward those companies that invest in Georgia-based securities. If a company is able to take advantage of the abatement, the premium tax rate can be reduced to 0.50 percent. Our empirical

³ The data for this exercise came from the NAIC's Annual Statement Tapes for the Property-Liability (Non-life industry). Unfortunately, similar data were not available for the life insurance sector, so a life insurance industry effective tax rate that includes local taxes could not be obtained.

results show the major beneficiaries of this abatement to be small insurance companies and domestic (i.e, Georgia-based) insurance companies.

There are a number of problems with this abatement. First, if it's purpose is to encourage economic development, then a more direct approach, such as a jobs or wage credit is warranted. Second, if economic development is an important goal, it is not being met by the current abatement because large non-Georgia insurance companies (which make up the supra majority of Georgia's market) are not always able to take advantage of the abatement. To invest so much of a large company's asset base in one state is neither practical nor prudent.

Another equity problem arises because of the operation of the retaliatory tax. Because Georgia's nominal rate is higher than the national average, the domestic insurance industry must pay additional taxes to states with lower rates due to the operation of the retaliatory tax. Every state except Hawaii has a retaliatory tax provision which essentially requires an insurer domiciled in State A and operating in State B to pay the higher of its own state's tax or the tax of State A. Thus, a Georgia company operating in Florida would pay the Georgia rate on its Florida premiums to the state of Florida since the Georgia rate is higher than Florida's 1.75 percent rate. Because Georgia's rate is higher than in nearly all surrounding states, the retaliatory tax hinders the development of Georgia's domestic companies because they are not competitive in the out-of-state market.

The Georgia premium tax has three separate reform opportunities. First, removing the disparate treatment found in the various abatements in the premium tax can reduce differences in treatment between life, health, and non-life companies.

Second, in conjunction with the removal of abatements, serious thought should be given to lowering the premium tax to be in line with the national average in order to reduce the negative impact of the retaliatory tax.

Third, serious consideration is merited for changing the structure of the tax from a gross revenue tax to one that is more in line with traditional corporations. This is a long-run reform option that will require serious thought because of the competition that will develop from various actors in the financial service industry. Banks, thrifts, and non-bank financial service corporations should be treated in approximately similar ways. The entire structure of the tax will require examination if people choose products solely because of their tax treatments. The revenue impact of changing from a premium tax to an income tax would be substantial, as the effective tax rate on premiums would be reduced dramatically.

A major problem with tax reform in the financial services industry is that while it is easy to see differences between insurers, banks, and non-bank financial services companies, it is much more difficult to see the similarities. However, with increasing competition among these industries, it will be easier to see the similarities, as the proposed mergers of Travelers and Citicorp illustrate. When banks start marketing insurance or when insurers start selling mutual funds, these differences will be immaterial. Thus, it is important to put all financial service taxes under scrutiny.

INSURANCE TAXATION IN GEORGIA: ANALYSIS AND OPTIONS

Introduction

Insurance plays a valuable role in the economy of the State of Georgia. Coverage is readily available for property damage and liability, workers compensation, health, accidents and disability, and for an individual's life. It is available directly to the individual, as part of one's employee benefits, and to corporations. Insurance is a relatively unique type of service. It is the archetypal service that consumers do not appreciate until it does not exist. Further, there are markets such as for health insurance or liability insurance in which insurance is almost a necessity, but may be difficult to purchase due to its expense. Private insurance also provides a safety net for individuals and for business that, in the absence of the private market, may need to be covered by the government. To the extent that government tax policy interferes with the insurance markets or reduces incentives to purchase insurance, problems in the market can be exacerbated. Thus, in discussing the taxation of insurance it is important to note the importance of this industry and realize that state tax policy affects the development of the industry, the provision of coverage, and the growth of the industry.

This report covers the taxation of the insurance industry in the State of Georgia. The report first demonstrates the size and importance of the insurance industry to the state and compares it to other important industries. Second, the report discusses the taxation of insurance in general, and at the state and local level in Georgia. Third, the report examines the structure of Georgia's insurance tax and compares it to other states, focusing on those in the Southeast. Fourth, the report examines the role of the premium tax in Georgia and discusses it in light of an optimal tax policy considering the tax's incidence and the tax's effect on equity, neutrality and simplicity of administration. Fifth, a simple tax calculator is employed to determine the effects

on revenue to the State of Georgia from various hypothetical changes in insurance taxation that might be implemented. Finally, the report undertakes an examination of possible changes in the current insurance tax policy of the state, and develops the implications of these changes based upon the empirical and theoretical analysis provided in the report.

Note that throughout this report, the term domestic firm refers to firms that are domiciled in the state, while foreign firm refers to firms that are domiciled out of the state, but not necessarily out of the U.S.

Size and Importance of the Insurance Industry to the State of Georgia

Tables 1 through 4 present statistics regarding the size of the industry from a number of perspectives. Table 1 shows that the insurance sector, in terms of gross state product¹, is approximately the size of the banking sector. In addition, Table 2 shows that the premium tax accounts for approximately 2.2 to 2.3 percent of the state's tax revenues, while the total corporate income tax accounts for between 5 to 6 percent of the total state tax revenues. In terms of employment, insurance tends to be relatively highly paid compared to other jobs in Georgia, and represents approximately 2.0 percent of the jobs in Georgia (Table 3).

Table 4 shows the size of the industry in another dimension. Table 4 shows the amount of premiums spent in the life industry, annuity considerations, non-HMO health insurance provided by life companies, average amounts of life insurance per household, and benefits paid to Georgia citizens in 1995. Further, it shows the premiums paid to the non-life (or property-liability industry) as well as losses incurred in Georgia in 1995.

¹ Gross state product is the sum of the gross market value of all goods and services produced in a state.

Table 1. Share of the Economy in Terms of Domestic State Product, 1991-1993

	1991	1992	1993
Bank Sector as % of total GSP	2.14%	1.98%	2.03%
Insurance Sector as % of total GSP	1.93%	2.07%	2.10%

Source: U.S. Department of the Commerce, STAT-USA/Internet

Table 2. Size with Respect to State Tax Revenues, 1992-1994

	1992	1993	1994
Total state revenues (000s)	\$ 7,266,981	\$ 8,150,344	\$ 8,449,000
Total Premium Taxes Paid by Insurance to State (000)	\$166,827	\$179,668	\$198,773
% of Total State Revenues	2.30%	2.20%	2.35%
Corp Income Tax (\$000s)	\$367,290	\$460,940	\$519,930
% of Total State Revenues	5.05%	5.66%	6.15%

Source: State of Georgia, *Budget Report for Fiscal Years 1991-1993*.

Table 3. Employment in FIRE and Insurance Sectors

	1992	1993
Finance Insurance & Real Estate (FIRE)	160,544	163,456
<i>Average FIRE Annual Wage</i>	\$32,621	\$33,759
Life Insurance Employment	13,569	13,477
<i>Average Life Insurance Annual Wage</i>	\$34,074	\$36,213
Accident and Health	1,982	N/A
<i>Average Health Insurance Annual Wage</i>	\$31,706	N/A
Fire Marine and Casualty Insurance	16,204	16,125
<i>Average Fire and Marine and Casualty Annual Wage</i>	\$34,758	\$35,810
Ins Agents, Brokers, and Service	19,248	19,455
<i>Average Ins Agents, Brokers, and Service Ann Wage</i>	\$34,354	\$34,721
% Georgia Workforce in Insurance	2.15%	2.00%
	\$24,572	\$24,690
Average annual wage for Georgia		

Source: U.S. Department of Labor, Employment and Wages, (1992-1993).

Table 4. Statistics of the Insurance Industry in Georgia, 1995

Life Insurance Industry	Premiums Written (\$thousands)	Benefits Paid (not including annuities) (\$thousands)	Life Insurance In Force (per household)
	2,819,000	3,153,840	\$143,500
Property-liability Industry	Premiums Written (\$thousands)	Losses Incurred (\$thousands)	
	\$526,620	\$9,367	N/A.

Source NAIC Data Tapes, 1995 and ACLI *Factbook* (1996).

The amounts of premiums collected and losses and benefits paid are significant in absolute dollars terms. Thus, it is important to examine the state's tax policy in a clear, systematic and objective manner. Identifying the goals of a tax policy is a start to this process.

Criteria of Good Tax Policy

Before examining Georgia's tax system, it is important to understand the general characteristics of a good tax infrastructure. Corporations do not pay taxes in the sense that they are not the ultimate bearer of the tax. Corporations are merely a collection mechanism for the tax authority. The ultimate taxpayers are capital providers (shareholders), consumers, and laborers. Each bears a particular burden that depends, in part, on the ability of the capital owner, consumer, or worker to avoid the tax. As a quick example, if health insurance sold by life insurance companies has a lower tax rate than that imposed on property-liability insurers, consumers will, all things being equal, prefer the lower taxed product. Thus, consumers can avoid the tax by purchasing artificially higher levels of health insurance sold by life insurers, thus shifting the burden of the tax to property-liability company owners, workers, and consumers.

Thus, it is imperative to examine who ultimately pays the tax on premiums and then assess whether this payment is good under a set of standard objectives. Economists believe that a tax system should satisfy a number of important criteria:

- Equity
- Neutrality
- Elasticity
- Stability
- Economic Development
- Simplification
- Obsolescence

See Box 1 for a discussion of the criteria.

Equity concerns the distribution of the tax burden among taxpayers. Equity can be viewed in two ways. First, there is the notion of horizontal equity. Horizontal equity is achieved when taxpayers in similar situations have a similar tax burden. Banks, thrifts, insurance companies, and other financial service providers should be taxed in an approximately equal manner. From a corporate perspective the stakeholders of a corporation (capital owners, employees, and customers) should bear approximately equal burdens across like industries.

Second, equity can be viewed vertically, that is, those with higher incomes are expected to pay more because of their higher ability to pay. This is the basis for the progressivity of the federal income tax. Although this criteria is the subject of debate regarding income taxes, it is not as relevant for business taxes.

The neutrality objective concerns the idea that decisions should not be made by consumers, capital owners, workers, or management based on tax considerations. For example, if two savings contracts were offered by a bank and an insurer, the consumer should not choose one over the other *solely* on the basis of tax consequences. Similarly, a company should not make an investment decision solely on the basis of tax policy.

Elasticity concerns the long-run growth potential of the tax system. For example, if income increased and the long-run tax revenue growth decreased, there may be implications for the development of the industry. We are interested in the question of whether there is a link between economic development (growth of the state's income) and the growth of tax revenues. Ideally, tax revenues should grow in line with income if public expenditure needs grow along with income.

Stability pertains to how tax revenues vary over the business cycle. If revenues fall when the demand for government services is strongest, there is a mismatch that puts the fiscal planners in the situation of raising taxes (or cutting expenditures) in a recession. A portion of the insurance industry (i.e. the property-liability industry) suffers from pronounced cycles (Stewart 1985; Grace and Hotchkiss 1995). These cycles can influence the stability of the premium tax as an income source.

Economic development is an important goal, as the state should desire to encourage (rather than discourage) development. As will be mentioned below, development has associated costs in terms of pollution or congestion, but policies that discourage development can harm the long-run fiscal structure of the state.

A tax system should also be simple. Over time, the tendency is for tax structures to become more complex. A good objective is to keep the tax structure simple by examining the goals the system is supposed to accomplish and then designing a tax that accomplishes the goals in the most parsimonious manner.

Finally, a tax system should be evaluated in terms of whether its goals are obsolete. Technological change may cause whole industries to restructure and to make previous distinctions between firms meaningless. This is especially true for the financial services sector.

Box 1. Characteristics of a Good Tax Structure

Each of the criteria is more important for some taxes than for others, but the overall tax system should be viewed in light of some combination of these criteria. The next sections will evaluate the Georgia premium tax in light of these criteria. Keep in mind that the failure to

satisfy one criteria for a particular tax is not necessarily economically detrimental because there is the entire tax system to consider. However, it is informative to examine each and every tax separately to see how it compares to the above goals of taxation.

The Georgia Insurance Industry in Relation to the United States

Figures 1 and 2 show the growth of the insurance industry over the last twenty years. Figure 1 shows the non-life (or property-liability) premium growth rate for Georgia and the United States. Georgia seems to track the nationally growth rate well for the property-liability industry, while for the life insurance industry (Figure 2) the premium growth rate is more volatile than that of the U.S., especially in the last decade. Although it is expected that any one state may not track the national average, Georgia's recent volatility has no apparent explanation other than the general economic and demographic shifts that have effected Georgia in the last decade.

Table 5 shows the 1994 per capita premium taxes paid by Georgia and the other states. Georgia ranked 31st in 1994 in per capita income. Georgia paid premium taxes of \$28.93 per capita which ranked 38th. Hawaii has the highest per capita tax (\$148.02), while Illinois ranked 51st, with a per capita tax of \$12.08. The national average was \$37.64. Before concluding that Georgia's tax was relatively low, it should be noted that Georgia's local governments impose additional premium taxes not included in these figures, so the above figures underestimate the actual per capita figure.²

Tables 6 and 7 show the amount of premium writings by Georgia and non-Georgia companies by state. Table 6 shows the non-life industry. The second column shows the premiums written in each state by Georgia (domestic) companies while the third column shows premiums

² The impact of the local taxes is discussed below in the section entitled "Examination of Georgia's Tax."

Figure 1
Non-Life Growth Rates for Georgia & U.S., 1975-1994

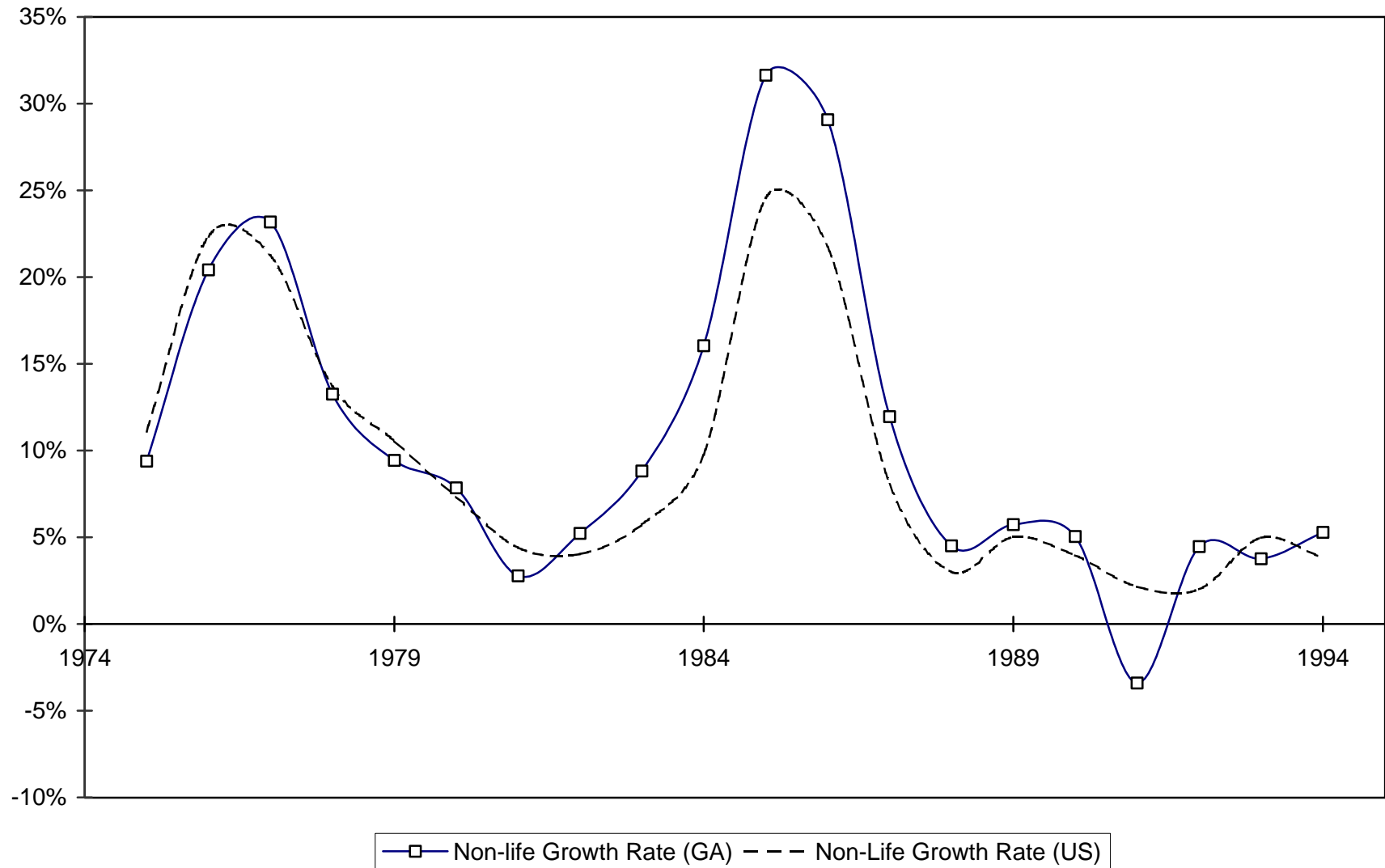


Figure 2
Growth of Life and Health Premiums by Life Insurers,
Georgia & U.S. , 1975-1994

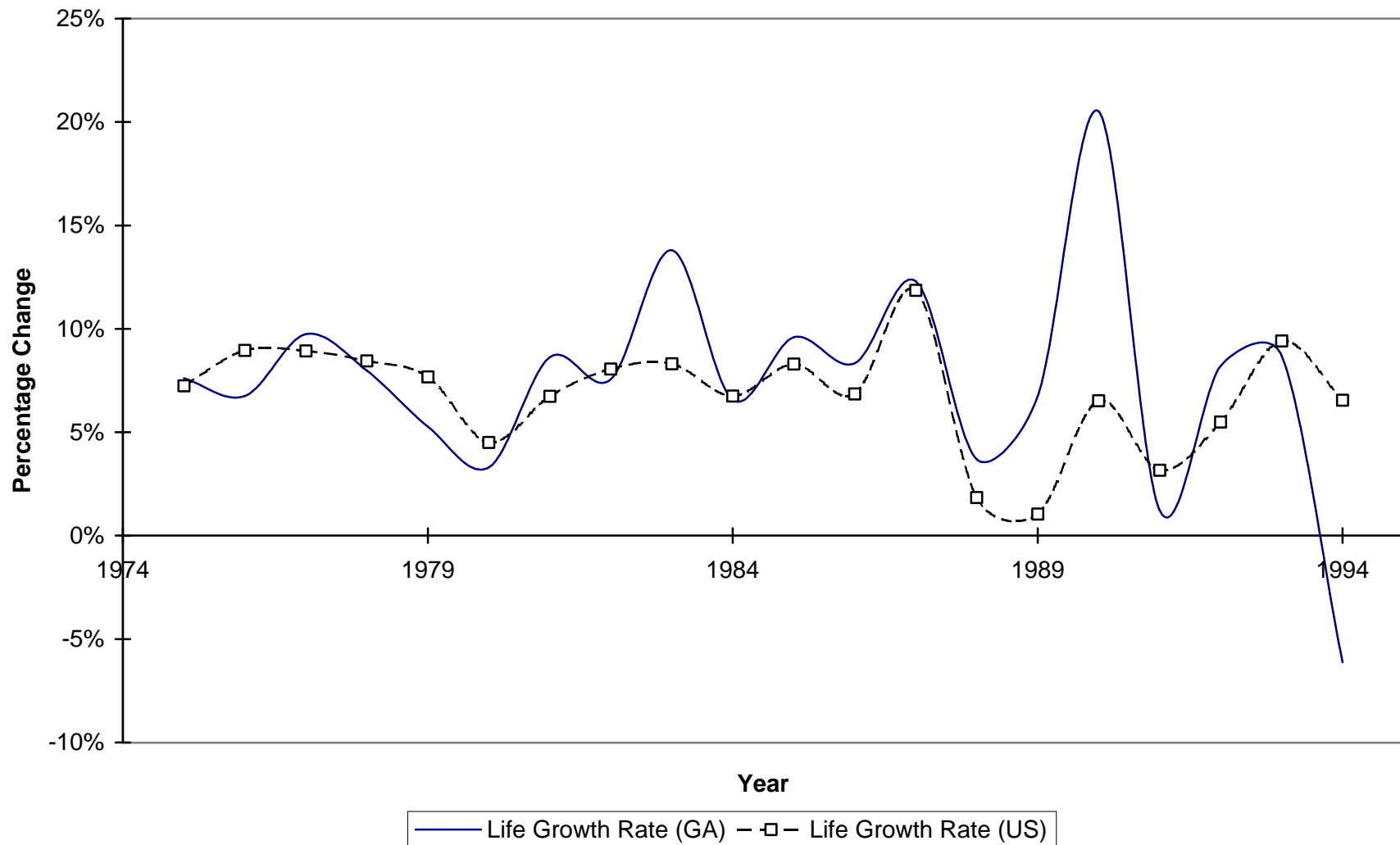


Table 5. Per Capita Income and Premium Tax Collections, 1994

State	Per Capita Income- 1994	Rank	1994-Premium Tax	Per capita Premium Tax	Rank
Alabama	\$16,022	41	\$166,364	\$39.78	14
Alaska	\$21,175	7	\$26,109	\$43.40	10
Arizona	\$16,748	38	\$134,971	\$34.48	25
Arkansas	\$14,995	49	\$62,942	\$25.99	42
California	\$19,593	13	\$977,529	\$31.13	32
Colorado	\$19,022	20	\$103,191	\$29.06	37
Connecticut	\$24,732	2	\$167,845	\$51.20	7
Delaware	\$19,381	18	\$50,009	\$71.54	2
Dist. of Columbia	\$25,832	1	\$36,333	\$62.97	4
Florida	\$19,076	19	\$378,461	\$27.56	40
Georgia	\$17,677	31	\$198,773	\$28.93	38
Hawaii	\$20,537	10	\$174,515	\$148.02	1
Idaho	\$16,293	40	\$48,464	\$44.18	9
Illinois	\$20,587	11	\$141,426	\$12.08	51
Indiana	\$17,301	28	\$132,472	\$23.17	44
Iowa	\$17,529	34	\$103,327	\$36.54	22
Kansas	\$18,140	26	\$95,619	\$37.53	17
Kentucky	\$15,446	46	\$260,391	\$68.76	3
Louisiana	\$15,754	42	\$246,250	\$57.11	5
Maine	\$17,559	33	\$40,341	\$32.64	29
Maryland	\$21,293	6	\$147,489	\$29.70	34
Massachusetts	\$21,649	5	\$290,189	\$48.43	8
Michigan	\$19,517	15	\$201,094	\$21.20	48
Minnesota	\$18,919	21	\$150,069	\$33.15	27
Mississippi	\$14,362	51	\$97,296	\$36.97	19
Missouri	\$18,226	23	\$195,004	\$37.33	18
Montana	\$15,615	44	\$32,506	\$38.88	15
Nebraska	\$18,089	27	\$40,494	\$25.01	43
Nevada	\$20,815	8	\$77,279	\$56.04	6
New Hampshire	\$20,730	9	\$40,037	\$35.81	24
New Jersey	\$23,929	3	\$257,910	\$32.91	28
New Mexico	\$15,308	48	\$34,929	\$21.64	45
New York	\$22,047	4	\$688,284	\$37.94	16
North Carolina	\$17,116	37	\$225,408	\$32.45	30
North Dakota	\$16,664	39	\$17,311	\$27.22	41
Ohio	\$18,195	24	\$325,865	\$29.41	35
Oklahoma	\$15,575	45	\$134,882	\$41.75	12
Oregon	\$17,419	35	\$64,295	\$21.22	47
Pennsylvania	\$19,418	17	\$433,370	\$35.96	23
Rhode Island	\$19,544	14	\$36,844	\$36.70	21
South Carolina	\$15,709	43	\$69,666	\$19.10	50
South Dakota	\$17,751	30	\$29,746	\$41.37	13
Tennessee	\$17,337	36	\$171,340	\$33.64	26
Texas	\$17,668	32	\$754,674	\$41.97	11
Utah	\$14,938	50	\$39,959	\$21.49	46
Vermont	\$17,763	29	\$17,931	\$31.29	31
Virginia	\$19,501	16	\$196,416	\$30.37	33
Washington	\$19,886	12	\$146,309	\$27.84	39
West Virginia	\$15,445	47	\$66,813	\$36.79	20
Wisconsin	\$18,151	25	\$103,806	\$20.52	49
Wyoming	\$18,271	22	\$13,878	\$29.34	36
National Average	\$18,449		\$169,538	\$37.64	

Source:

Bureau of the Census.

**Table 6. Georgia Domestic Premiums Earned and Percent of Market Served
By Georgia Domestics by State for Non-Life Insurance, 1994**

State	Georgia Domestic Premiums Earned	Total Market Premiums Earned	% Mkt. GA Companies
Alaska	\$44	\$736,892,272	0.00%
Alabama	\$40,888,092	\$3,311,273,551	1.23%
Arkansas	\$3,952,194	\$2,158,227,112	0.18%
Arizona	\$4,204,134	\$4,073,659,583	0.10%
California	\$1,552,307	\$34,860,187,620	0.00%
Colorado	\$4,057,864	\$4,101,697,692	0.10%
Connecticut	\$22,467,432	\$4,336,956,385	0.52%
Dist. of Col.	\$666,375	\$812,924,744	0.08%
Delaware	\$951,875	\$1,150,262,907	0.08%
Florida	\$67,645,203	\$14,451,812,699	0.47%
Georgia	\$858,710,959	\$5,612,647,007	15.30%
Hawaii	\$986,986	\$1,619,059,598	0.06%
Iowa	\$1,864,356	\$2,514,177,549	0.07%
Idaho	\$473,741	\$1,078,418,325	0.04%
Illinois	\$5,640,856	\$12,071,400,816	0.05%
Indiana	\$1,493,368	\$5,736,697,461	0.03%
Kansas	\$1,045,493	\$2,437,620,287	0.04%
Kentucky	\$11,909,046	\$3,025,649,528	0.39%
Louisiana	\$29,157,364	\$4,217,264,708	0.69%
Massachusetts	\$8,916,931	\$7,834,321,543	0.11%
Maryland	\$3,510,241	\$4,564,688,433	0.08%
Maine	\$1,011,197	\$1,165,215,417	0.09%
Michigan	\$10,614,588	\$9,762,808,635	0.11%
Minnesota	\$6,091,243	\$4,850,937,573	0.13%
Missouri	\$4,746,839	\$4,990,163,012	0.10%
Mississippi	\$10,244,029	\$2,020,110,891	0.51%
Montana	\$716,658	\$784,960,902	0.09%
North Carolina	\$42,557,012	\$5,560,315,840	0.77%
North Dakota	\$104,768	\$587,140,012	0.02%
Nebraska	\$7,976,030	\$1,663,941,136	0.48%
New Hampshire	\$2,487,049	\$1,201,475,517	0.21%
New Jersey	\$2,032,179	\$10,597,289,605	0.02%
New Mexico	\$457,591	\$1,434,102,790	0.03%
Nevada	\$522,742	\$1,411,626,361	0.04%
New York	\$80,792,151	\$20,661,027,264	0.39%
Ohio	\$4,460,897	\$10,050,784,814	0.04%
Oklahoma	\$2,472,709	\$2,832,934,050	0.09%
Oregon	\$1,642,280	\$3,091,537,262	0.05%
Pennsylvania	\$14,917,221	\$13,084,659,646	0.11%
Rhode Island	\$900,207	\$1,202,436,877	0.07%
South Carolina	\$9,384,008	\$3,209,527,848	0.29%
South Dakota	\$541,144	\$723,166,802	0.07%
Tennessee	\$10,888,675	\$4,389,352,450	0.25%
Texas	\$5,262,838	\$18,338,088,713	0.03%
Utah	\$2,975,412	\$1,540,092,579	0.19%
Virginia	\$19,586,230	\$5,233,372,798	0.37%
Vermont	\$1,109,474	\$694,707,968	0.16%
Washington	\$2,243,507	\$4,586,730,939	0.05%
Wisconsin	\$4,670,832	\$4,812,582,652	0.10%
West Virginia	\$692,176	\$1,333,079,045	0.05%
Wyoming	\$108,195	\$394,116,725	0.03%

Source : Author's calculations from NAIC Annual Statement Tapes, 1994

Table 7. Georgia Premiums Earned and Percent of Market Served by Georgia Domestics by State for Life Insurance, 1994

State	Georgia Domestic Premiums Earned	Total Market Premiums Earned	% Mkt. GA Companies
Alaska	\$55,821	\$213,985,455	0.0260
Alabama	\$29,937,436	\$1,641,951,876	1.8230
Arkansas	\$4,220,557	\$934,275,718	0.0452
Arizona	\$1,394,669	\$1,626,794,607	0.0860
California	\$3,329,967	\$13,695,048,924	0.0240
Colorado	\$722,209	\$1,813,574,055	0.0400
Connecticut	\$107,427	\$2,946,055,963	0.0004
Dist. of Col.	\$229,724	\$352,504,461	0.0650
Delaware	\$28,285	\$982,095,108	0.0030
Florida	\$33,902,351	\$6,710,869,540	0.5050
Georgia	\$149,052,760	\$2,955,261,753	5.0440
Hawaii	\$80,975	\$655,696,905	0.0120
Iowa	\$2,679,624	\$1,797,538,323	0.1490
Idaho	\$890,696	\$480,237,322	0.185
Illinois	\$4,432,495	\$7,200,272,920	0.062
Indiana	\$1,619,223	\$3,058,752,309	0.053
Kansas	\$-	\$1,360,264,682	0.000
Kentucky	\$6,431,859	\$1,391,561,689	0.046
Louisiana	\$10,788,652	\$1,895,980,856	0.057
Massachusetts	\$3,326,584	\$3,335,947,466	0.100
Maryland	\$514,690	\$2,368,426,027	0.022
Maine	\$22,083	\$445,145,505	0.005
Michigan	\$12,081,557	\$5,304,010,743	0.228
Minnesota	\$8,570,452	\$2,678,042,071	0.320
Missouri	\$2,516,244	\$2,681,698,467	0.001
Mississippi	\$12,762,650	\$872,668,216	1.462
Montana	\$577,685	\$342,495,583	0.169
North Carolina	\$53,476,018	\$3,515,986,534	1.521
North Dakota	\$245,554	\$352,121,183	7.000
Nebraska	\$1,403,807	\$1,222,922,645	0.115
New Hampshire	\$31,771	\$569,636,934	0.006
New Jersey	\$165,110	\$6,045,127,829	0.003
New Mexico	\$822,843	\$893,349,040	0.092
Nevada	\$153,225	\$561,871,190	0.027
New York	\$321,116	\$10,503,119,013	0.003
Ohio	\$22,807,409	\$6,232,216,245	0.366
Oklahoma	\$4,166,872	\$1,258,271,378	0.331
Oregon	\$344,640	\$1,494,341,160	0.023
Pennsylvania	\$846,943	\$6,408,922,670	0.013
Rhode Island	\$129,872	\$533,449,059	0.024
South Carolina	\$58,774,234	\$1,521,983,788	3.862
South Dakota	\$512,911	\$357,640,633	0.143
Tennessee	\$53,793,999	\$2,264,133,231	2.376
Texas	\$12,352,614	\$7,607,882,233	0.162
Utah	\$585,062	\$813,737,387	0.072
Virginia	\$22,448,558	\$3,360,946,114	0.668
Vermont	\$7,311	\$265,301,755	0.003
Washington	\$1,439,464	\$2,894,535,832	0.050
Wisconsin	\$4,310,307	\$2,441,098,834	0.177
West Virginia	\$1,379,781	\$649,883,179	0.212
Wyoming	\$185,959	\$193,242,491	0.096

written by non-Georgia companies. In 1994, Georgia non-life domestic firms wrote approximately 15.3 percent of the insurance in the Georgia market. The next largest state in terms of the premiums written by Georgia firms was Alabama, with just over 1 percent of that market being served by Georgia companies. Total premiums written nationwide by Georgia domestics nationwide amounted to approximately 0.50 percent of national premiums. Thus, the Georgia non-life industry is relatively small.

The story is similar for the life industry, except that the Georgia life industry accounts for 5.04 percent of Georgia market (Table 7). However, Georgia accounts for greater than one percent in four other markets. Nationwide, Georgia domestics account for only 0.40 percent of total premiums written by life insurers.

Georgia's domestic health insurance industry market share amounts to over 6.2 percent of the Georgia market (Table 8). The next largest states with Georgia writings are Mississippi, Hawaii, and Alabama. Nationwide, Georgia domestics account for 1.2 percent of life and health premiums written.

Relationship Between Georgia and Tax Policy of Other States

A simple regression was estimated to determine the response between Georgia's premium tax collections and the premiums within the state. From this regression an estimate of the elasticity between collections and premiums was obtained. A similar regression and elasticity estimated was obtained for the U.S. These are shown in Table 9 in panels A and B respectively.

An elasticity value of 1 implies that for a 10 percent change in premiums, taxes will rise by 10 percent. For the State of Georgia the elasticity is less than 1, so that a 10 percent rise in premiums will result in a 9.80 percent increase in tax revenues. A 10 percent change nationwide will result in a slightly more than 10 percent (10.90 percent) increase in premium taxes. The implication of this is that Georgia's tax collections are slightly less sensitive to premium growth

**Table 8. Georgia Domestic Premiums and Percent of Served by
Georgia Domestics by State for Health Insurance, 1994**

State	Georgia Domestic Premiums Earned	Total Market Premiums Earned	% Mkt. GA companies
Alaska	\$313,166	\$258,997,263	0.121%
Alabama	\$33,959,690	\$817,814,629	4.152%
Arkansas	\$13,213,367	\$988,086,379	1.337%
Arizona	\$7,444,917	\$924,563,133	0.805%
California	\$26,377,980	\$6,066,657,204	0.435%
Colorado	\$7,044,793	\$1,034,955,148	0.681%
Connecticut	\$241,592	\$2,272,661,604	0.011%
Dist. of Col.	217,394	\$442,386,453	0.049%
Delaware	\$1,001,124	\$198,719,725	0.504%
Florida	\$76,001,144	\$5,617,223,166	1.353%
Georgia	\$131,009,117	\$2,094,510,226	6.255%
Hawaii	\$968,194	\$130,196,485	4.584%
Iowa	\$11,625,753	\$1,618,963,924	0.718%
Idaho	\$5,177,694	\$176,581,907	2.932%
Illinois	\$34,253,466	\$6,024,034,100	0.569%
Indiana	\$8,221,356	\$2,092,395,019	1.827%
Kansas	\$6,426,875	\$1,350,126,316	0.476%
Kentucky	\$16,304,020	\$737,325,557	2.211%
Louisiana	\$29,990,922	\$1,377,234,024	2.178%
Massachusetts	\$249,640	\$1,343,241,267	0.019%
Maryland	\$5,173,794	\$1,062,139,958	0.487%
Maine	\$2,864,656	\$298,622,168	0.959%
Michigan	\$33,398,229	\$1,653,152,562	2.020%
Minnesota	\$18,567,085	\$897,582,583	2.069%
Missouri	\$13,396,376	\$1,539,313,308	0.870%
Mississippi	\$35,566,423	\$660,252,889	5.387%
Montana	\$1,865,519	\$8,560,776	0.854%
North Carolina	\$53,348,039	\$1,879,867,730	2.838%
North Dakota	\$5,465,670	\$143,356,788	3.813%
Nebraska	\$9,509,647	\$899,066,943	1.058%
New Hampshire	\$300,201	\$297,996,729	0.101%
New Jersey	\$265,622	\$2,897,643,451	0.009%
New Mexico	\$4,411,872	\$302,943,179	1.456%
Nevada	\$3,571,969	\$387,204,556	0.923%
New York	\$500,569	\$5,723,176,633	0.009%
Ohio	\$29,249,907	\$2,621,151,110	1.116%
Oklahoma	\$8,836,102	\$872,813,464	1.012%
Oregon	\$9,953,241	\$518,158,231	1.921%
Pennsylvania	\$30,085,985	\$2,153,654,593	1.397%
Rhode Island	\$503,028	\$136,034,647	0.370%
South Carolina	\$34,889,072	\$896,501,866	3.892%
South Dakota	\$9,869,206	\$315,633,797	3.127%
Tennessee	\$54,802,329	\$1,481,874,102	3.698%
Texas	\$65,459,921	\$9,977,114,738	0.656%
Utah	\$6,334,874	\$513,040,154	1.235%
Virginia	\$38,473,885	\$2,843,163,012	1.353%
Vermont	\$586,359	\$107,373,616	0.546%
Washington	\$10,482,437	\$875,676,816	1.197%
Wisconsin	\$15,914,112	\$1,538,823,469	1.034%
West Virginia	\$11,547,358	\$411,818,112	2.804%
Wyoming	\$818,150	\$129,098,962	0.634%

than the rest of the country, but, this difference, while statistically different at the 0.01 level, is economically minimal.

Another way to examine the sensitivity of the tax system is to examine the relationship between insurance tax receipts and state income. Panel B of Table 9 shows the income elasticity for the insurance premium tax for Georgia and for the U.S.³ The income elasticity of taxes is the best way to judge the ability of a tax to generate sufficient revenues over a number of years (Fox: 1996).

For both the U.S. and the state of Georgia, the income elasticity is close to one for the premium tax. The U.S.'s elasticity is slightly less than one, implying that a 10 percent increase in personal income results in a 9.0 percent increase in premium tax revenues, while for Georgia a 10 percent increase in income generates a 10.0 percent increase in tax revenues. This suggest that Georgia's tax revenues are slightly more elastic than the national average, and that as income increases Georgia can expect a greater revenue impact for the premium tax than can be expected by the nation as a whole.

Table 9. U.S. Elasticity Comparisons

Panel A. <i>Comparison of Premium -Tax Revenue Elasticities</i>	
Georgia Elasticity between Premium Tax Collections and Premiums	0.980
U.S. Elasticity between Premium Tax Collections and Premiums	1.090
Panel B. <i>Comparison of Premium Tax-Income Elasticities</i>	
Georgia Elasticity between Premium Tax Collections and Personal Income	1.000
U.S. Elasticity between Premium Tax Collections and Personal Income	0.901

³ The elasticity is the percentage change in tax revenues over the percentage change in personal income. A value of one indicates that the growth in revenue generated from the tax is consistent with the growth in income.

Figure 3 shows the percentage change in real insurance premium tax revenues (deflated by the CPI) for 1974-1994 for Georgia and the U.S. We can see that the premium tax is a volatile source of revenue for both the state of Georgia and the U.S. Georgia seems slightly more volatile than the other states, especially in the last decade.⁴ In terms of the coefficient of variation (CV), the Georgia non-life series has a CV of 0.851, which is slightly greater than the U.S. CV of 0.779.⁵ For the life series, Georgia's CV is 0.689 compared to 0.382 for the U.S. as a whole.

History of Insurance Taxation in United States and Georgia

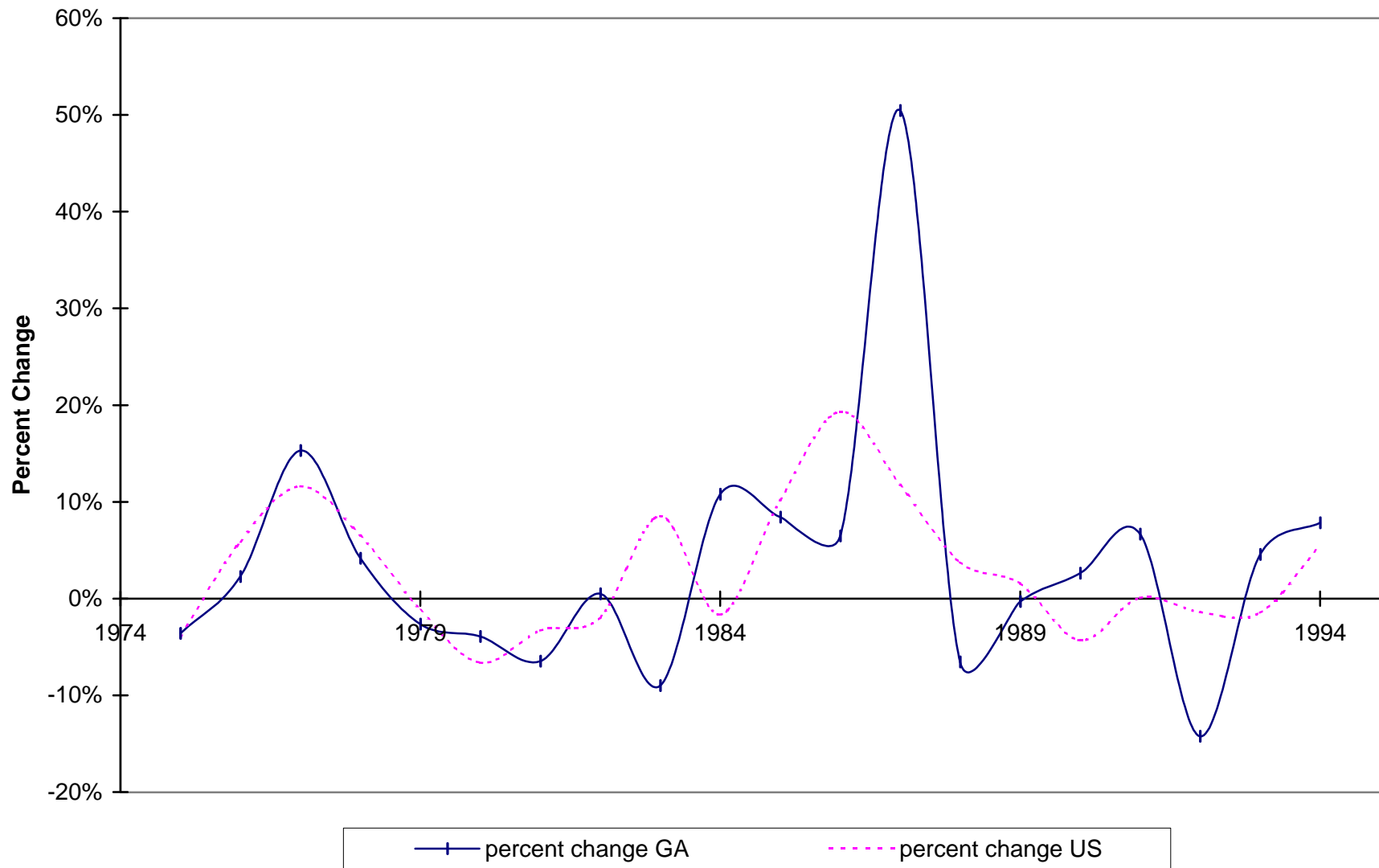
Historically, insurance premiums are taxed rather than notions of net income. This has been done for one major reason: simplicity. The calculation of net income for an insurance company is conceptually quite difficult. This can be seen by the following example. Since premiums are collected today, but losses are not realized until a number of periods henceforth, it is difficult to determine net income. When an insurer saves a portion of the premium that it receives today to cover an eventual expected loss (i.e., a claim) it creates a reserve. These reserves are set up to cover future liabilities. However, to the tax collector these reserves resemble retained earnings, or income. In actuality, there are no retained earnings or income, as there is a current incurred liability that offsets that reserve.⁶ Furthermore, even if the tax collector understood the special nature of the insurance contract, the tax collector and the insurer

⁴ There are no known reasons for the increased volatility in Georgia's life and health premiums relative to the national figure. A conjecture is that changes in Georgia's demographics and income over the last seven years could have led to changes in the demand for insurance.

⁵ The coefficient of variation is the standard deviation of a series of numbers divided by the mean of the series. This coefficient of variation provided a standardized way of comparing the "volatility" of the U.S. and Georgia series. A higher CV implies a higher level of volatility.

⁶ For a more detailed description of the accounting of taxable income for the U.S. corporate income tax for property-liability industry see Mooney and Cohen (1991). Black and Skipper (1994) have a description of the corporate income tax accounting problems for the life industry.

Figure 3
Percentage Change Real Tax Revenues for Georgia and U.S.



must agree on an appropriate interest rate to discount the reserves in order to calculate net income for the current year (see Aaron (1981)). In addition, assuming the reserves are properly discounted, one may question the appropriateness of taxing reserves. This is because the reserves are the financial capital backing future losses. State solvency regulatory policy requires that the companies keep higher reserves than they might otherwise keep. This is to reduce the risk of insolvency, and thus, companies with the required reserves would pay more taxes than those that do not keep the required reserves.

Because of all of these problems, and the fact that a method of properly discounting the reserves was not available when insurance companies first become taxable, premium taxation was a simple solution. In fact, this is the predominant method for taxing insurance companies worldwide. However, its use has been strongly criticized, and a responsible state should recognize the implications of the premium tax for the long-run viability of the industry.⁷

The first states to tax the insurance industry imposed a tax on fire premiums to pay for the provision of fire department services to the local community. This first premium tax could be viewed as a property tax because the premium was based on the value of the property insured. As the need for state revenues grew, states started taxing more lines of insurance, so that the link between what was being insured and the receipt of a particular public service was no longer present. In many states fire insurance is still subject to a special tax, that usually is in addition to the premiums tax, to cover statewide fire prevention efforts as well as arson investigation and deterrence, as is discussed further below. In addition, the resemblance to the property tax weakened as the premium tax spread to all types of insurance coverage. Once it was realized that a simple tax placed on all insurance products could generate state revenues, states taxed all

⁷See Skipper (1987), and Skipper (1996) .

premiums regardless of whether there was a historical link to property which received some governmentally provided benefit such as fire protection.

The regulation and taxation of the industry was left almost entirely to the states, insurance was viewed as a local service, rather than one involving interstate commerce. In fact, a post-Civil War Supreme Court decision reaffirmed the fact that insurance was subject solely to state regulation and that the Congressional commerce power did not apply to the regulation and taxation of the industry.⁸ That changed in 1944, when the Supreme Court, in *U.S. v. Southeastern Underwriters*, held the insurance industry subject to the antitrust laws. Congress reacted by passing the McCarran Ferguson Act of 1945, that returned to the states the sole power over regulation and taxation of insurance. Because states had free reign to tax the insurance industry, a number of anomalies developed. First, because states were not subject to commerce clause restrictions on taxation, they could, and did, discriminate against out-of-state commerce by imposing a higher tax rate on out-of-state carriers.⁹ Second, states adopted defenses to this discriminatory taxation in the form of a so-called retaliatory tax.¹⁰ That is, if state A would tax state B's companies at a higher rate than its own companies, State B would tax State A's companies at the higher of the two states' tax rates.

The discriminatory premium tax was challenged successfully in *Metropolitan v. Ward*.¹¹ Alabama had a domestic preference that granted domestic (i.e., in-state) companies a very low tax rate, while taxing out-to-state (i.e., foreign) companies at a higher 4.0 percent rate. The Supreme Court examined the case from the perspective of the equal protection clause rather than

⁸*Paul v. Virginia* 75 U.S. (8 Wall.) 168 (1968).

⁹ The commerce power generally restricts states from taxing out-of-state companies at differentially higher rates. See *Bacchus Imports v. Dias*, 468 U.S. 263 (1984).

¹⁰ The Supreme Court upheld the use of retaliatory taxation by the states in *Western & Southern Life Insurance Company v. State Board of Equalization* (451 U.S. 648 (1981) based on the notion that Congress gave power to the states to tax and removed commerce power restrictions.

¹¹470 U.S. 869 (1985). See Grace and Skipper (1990) for a discussion of the discriminatory premium tax and a more thorough discussion of the legal issues involved.

the commerce clause, holding that the State had to have a rational basis to discriminate based upon an insurer's state of residence. The Court remanded the case back to Alabama to develop a rational basis for its tax. Alabama settled with Metropolitan, arguably because it could not come up with a rational basis for the discrimination. Many other states changed their law from facially discriminatory to facially neutral in the wake of the decision. As of 1996, only a few states such as Illinois¹² and Kansas have facially discriminatory taxes, while a group of states such as Texas, Georgia, Kansas, and Mississippi have laws that provide methods to reduce the tax rate in exchange for investments within the state. These abatements, such as Georgia's, often can only be used by small domestic companies, and thus, discriminate against larger and foreign companies. Although for practical purposes the law appears to include all companies in the state, some argue that realistically only certain companies are in the position of being able to qualify for the abatement. This is discussed further below.

The retaliatory tax was challenged in *Western and Southern Life Insurance Company v. State Board of Equalization*.¹³ It is commonly believed that the retaliatory tax is necessary to keep states from engaging in extreme domestic preferences that result in taxing other states' companies at high rates. In *Western and Southern*, the Court upheld the constitutionality of the retaliatory tax based on the congressional delegation of authority to the states in the McCarran-Ferguson Act. Because the commerce clause was not operative with regards to insurance, the Court allowed the state to tax in any way it deemed necessary.¹⁴

It is interesting to note, however, that in practice we see the incidence of the retaliatory tax being borne by the state's domestic industry. A number of states, such as Massachusetts and

¹² Late in 1997 an Illinois court, held that Illinois domestic preference violated the Illinois Constitution's equivalent of the equal protection clause. The law itself is expected to be rewritten in 1998.

¹³ 451 U.S. 648 (1981).

¹⁴ The Court did have trouble with the Equal Protection Clause argument, and this was the genesis for the Court's decision in *Metropolitan v. Ward* (470 U.S. 869 (1985)) invalidating the broad protection a state had in setting domestic preferential tax rates.

Connecticut, have taken the extreme position of taxing their domestic companies more than foreign companies, rather than subjecting their domestic companies to the effects of a retaliatory tax in other states. Massachusetts had a revenue shortfall, and desired to increase the insurance premium tax. By doing so, it would have raised the effective tax rate for Massachusetts companies - not just on business written in Massachusetts, but on business written by Massachusetts companies throughout the United States. The compromise was to tax Massachusetts domestic companies more than foreign companies so that Massachusetts' companies would not be subject to the retaliatory tax elsewhere.

Structure of Georgia Premium Tax Law

In Georgia there has been no change to the premium tax rate or to the tax base in over 40 years. The premium tax rate has been 2.25 percent since 1955. Georgia's tax base is gross premiums received in Georgia.¹⁵ Although the tax is set at a fixed rate, it does not bring in a steady source of revenue. Recall from Figure 3, the state's real premium tax income from 1974 to 1994 is volatile. Note that this tax revenue is also cyclical, mimicking the cycling in the profitability of the insurance industry, as well as the cycle in the general economy.

Tax Base

The tax base is the gross direct premiums *received* on policies issued in Georgia. This tax in Georgia is slightly different than most other states. Generally, the tax base is either premiums written, which is all the policies business sold within a state in a given year, or premiums earned. Premiums written equal the total premiums that will be paid during the life of the insurance policy. Premiums earned, however, is a statutory accounting construct in which the insurer recognizes premium revenue only when it is earned. For example, if a person paid for a policy one year in advance, the insurer would be able to "earn," or recognize, one-quarter of

¹⁵O.C.G.A. 33-8-4.

the amount in the first quarter of the year, another quarter of the amount in the second quarter, and so on until the total amount is recognized.

Premiums received allows the company to avoid paying taxes on premiums written until the policyholder actually pays the premiums to the insurer. Thus, as is often the case, companies collect premiums each month (or quarter) on installment plans; the company need not recognize a tax obligation until the insured pays the premiums. The difference between premiums written and premiums received is not especially important in the long run, as premiums written and premiums received will eventually be the same. In the short run, however, there will be a difference in the timing of the tax payments.

Tax Rate

Georgia's tax rate is 2.25 percent, and is seemingly among the higher rates in the country. For the property liability industry (or the non-life industry) the average rate is 2.09 percent and 2.29 percent for the domestic and foreign industries, respectively. For the life and health industry the average tax rates are 2.06 percent for the domestic industry and 2.13 percent for the foreign life industry. Table 10 shows the tax rates for the rest of the country for the property-liability industry, Table 11 shows the rates for the life industry, and Table 12 shows the rates for the health industry. Finally, Table 13 shows the rates of taxation for the annuity industry. Since annuities are like savings products, most states, including Georgia, do not tax them. Table 14 summarizes a number of the statistics for Georgia and other southeastern states.

It is interesting to look at Table 15, which shows the effective tax rates (fourth column) for all of the states for their respective insurance industries. The effective rate is calculated as

Table 10. Property-Liability Tax Rates

Table 11- Life Insurance Tax Rates

State	Domestic Rate %	Foteign Rate %	Income Tax Base (if any)
Alabama	1.6	2.8	
Alaska	2.7	2.7	
Arizona	2	2	
Arkansas(l)	2.5	2.5	
California	2.35	2.35	
Colorado	2.25	2.25	
Connecticut	1.75	1.75	
Delaware	2	2	
Florida	1.75	1.75	Fed Tax Inc
Georgia(1)	2.25	2.25	
Hawaii	2.75	2.75	
Idaho(l)	2.75	2.75	
Illinois		2	Fed Tax Inc.
Indiana	2	2	Statutory Net
Iowa	2	2	
Kansas	1	2	
Kentucky	2	2	
Louisiana	2.25	2.25	Statutory Net
Maine	2	2	
Maryland	2	2	
Massachussets	2	2	Net Income
Michigan	2.3	2.3	
Minnesota	2	2	Net Income
Mississippi	3	3	Statutory Net
Missouri	2	2	
Montana (5)	2.75	2.75	Fed Tax Inc.
Nebraska	1	1	Fed TaxInc
Nevada (2)	3.5	3.5	Fed TaxInc
New Hampshire	2	2	Fed Tax Inc.
New Jersey	2.1	2.1	
New Mexico(1)	3	3	
New York (6)	o.go	0.8	Statutory Income
North Carolina	1.9	1.9	
North Dakota	2	2	Fed Tax Inc.
Ohi(7)	2.5	2.5	
Oklahoma	2.25	2.25	
Oregon		2.25	Statutory Income
Pennsylvania	2	2	
Rhode Island	2	2	
South Carolina	0.75	0.75	
South Dakota	2.5	2.5	
Tennessee(1)	2	1.75	Net Income
Texas	2.4	2.4	
Utah	2.25	2.25	
Vermont	2	2	
Virginia(2)	2.25	2.25	
Washington	2	2	
West Virginia	3	3	
Wyoming	1.6	1.6	
Wisconsin	2	2	
Average	2.13	2.08	

Source: CCH, State Tax Guide, NAIC. Retaliatory Tax Gulde. 1996

Table 12 - Health Insurance Tax Rates

State	Domestic Rate%	Foreign Rate%	Blue Cross Rate%	HMO Rate%
Alabama	1.6	2.8	1.6	1
Alaska	2.7	2.7	60% of net income	2.7
Ariizona ~	2	2	-	2
Arkansas	2.5	2.5	1	2.5
California	2.35	2.35	-	-
Colorado	2.25	2.25	\$.05per enrollee	-
Cnnecticut	1.75	1.75	2	2
Delaware	2	2	-	-
District of Columbia	2.25	2.25	-	-
Florida	1.75	1.75	-	-
Georgia(1)	2.25	2.25	-	-
Hawaii	4.7	4.7	-	-
Idaho	2.75	2.75	-	-
Illinois		2	-	-
Indiana	2	2	-	-
Iowa	2	2	2	2
Kansas	1	2	1	1
Kentucky	2	2	2	2
Louisiana	2.25	2.25	2.25	2.25
Maine	2	2	0.02	-
Maryland	2	2	-	-
Massachusetts	2.28	2	-	-
Michigan	2.3	2.3	-	-
Minnesota	2	2	-	-
Mississippi	3	3	-	-
Missouri	2	2	-	-
Montana	2.75	2.75	-	-
Nebraska(2)	0.5	0.5	0.5	0.5
Nevada	3.5	3.5	3.5	
New Hampshire	2	2	-	2
New Jersey(3)	1.05	1.05	\$.02 per subscriber	
Nw Mexico	3	3	3	3
Nw York(4)	1	1	-	-
North Carolina	1.9	1.9	0.5	-
North Dakota	1.75	1.75	1.75	1.75
Ohio	2.5	2.5	2.5	
Okhlahoma	2.25	2.25	2.25	2.25
Oregon	-	2.25	-	-
Pennsylvania	2	2	-	-
Rhode Island	2	2	-	-
South Carolina	1.25	1.25	1.25	-
South Dakota	2.5	2.5	2.5	2.5
Tennessee	2.5	2.5	2.5	2
Texas	1.75	1.75		1.75 of gross reserves
Utah	-	-	-	-
Vermont	2	2	-	-
Virginia	2.25	2.25	0.75	-
Washington	2	2	2	2
West Virginia	3	3	-	-
Wisconsin(5)	2	2	-	-
Wyoming	0.75	0.75	0.75	-
Average	2	2.12	0.74	0.62

Table 13. Taxation of Annuities

State	Rate
Alabama	1%
California	0.5%
Florida	1.0% with exceptions
Kentucky	2.0% for foreign
Iowa	2% for those issued prior to 7/1/88, 0% thereafter
Maine	2.0% except for qualified retirement plans
Nebraska	1.0% except for qualified retirement plans
Nevada	3.5% except for qualified retirement plans
Mississippi	1%
Pennsylvania	2.0% except for qualified retirement plans
South Dakota	1.25%
West Virginia	1.0%
Wyoming	1.0% except for qualified retirement plans s

Source: NAIC *Retaliation Tax Guide*, 1996

Table 14. Comparison of Georgia with Other Southeastern States and Important Insurance States

State	Life Rate %	Non-Life Rate %	Effective Tax Rate %	Non-life Effective Rate % *
Alabama	2.80	3.6	3.35	3.65
Arkansas	2.50	2.5	1.84	3.11
California	2.35	2.35	2.07	2.44
Connecticut	1.75	2.00	2.29	2.64
Florida	1.75	1.75	1.70	3.08
Georgia	2.25	2.25	1.78	5.03
Illinois	2.00	2.00	.074	1.52
Kentucky	2.00	3.50	5.34	25.70
Louisiana	2.25	2.25	3.67	4.00
Massachusetts	2.00	2.28	2.59	2.38
Mississippi	3.00	3.00	2.87	3.16
New Jersey	2.10	2.10	1.49	1.93
New York	0.80	1.30	2.08	2.85
North Carolina	1.90	1.90	2.23	2.51
Ohio	2.50	2.50	2.17	1.60
South Carolina	0.75	1.25	1.38	3.59
Tennessee	2.00	2.50	2.26	2.65
Texas	2.40	3.50	2.41	2.41
Virginia	2.25	2.25	1.88	2.44

*Obtained from Page 14 of the NAIC Annual Statement Tapes for the Property-Liability Industry.
Data contained here includes all taxes, licenses, and fees to state and local governments.

Table 15 - Premiums, Effective Tax Rate and ACIR Premium Tax Capacity

State	1994 Premium Tax Receipts (000)	1994 Total Premiums	Effective Tax Rate (Receipts/premiums)	Nat'l Avg. Rate *Premiums=capacity	Receipts as a % of Capacity	Capacity Rank
Alabama	\$166,364	\$4,971,044,000	3.35%	\$104,548,442	159.13%	6
Alaska	\$26,109	\$1,130,083,000	2.31%	\$23,767,325	109.85%	20
Arizona	\$134,971	\$5,564,620,000	2.43%	\$117,032,228	115.33%	15
Arkansas	\$62,942	\$3,412,413,000	1.84%	\$71,768,116	87.70%	37
California	\$977,529	\$47,181,100,000	2.07%	\$992,288,643	98.51%	31
Colorado	\$103,191	\$5,940,317,000	1.74%	\$124,933,694	82.60%	41
Connecticut	\$167,845	\$7,316,054,000	2.29%	\$153,867,487	109.08%	21
Delaware	\$50,009	\$1,866,054,000	2.68%	\$39,245,889	127.42%	11
Dist of Columbia	\$36,333	\$1,478,283,000	2.46%	\$31,090,488	116.86%	14
Florida	\$378,461	\$22,224,396,000	1.70%	\$467,412,073	80.97%	42
Georgia	\$198,773	\$11,194,582,000	1.78%	\$235,438,694	84.43%	40
Hawaii	\$174,515	\$2,145,582,000	8.13%	\$45,124,778	386.74%	1
Idaho	\$48,464	\$1,401,815,000	3.46%	\$29,482,253	164.38%	5
Illinois	\$141,426	\$19,168,874,000	0.74%	\$403,149,905	35.08%	51
Indiana	\$132,472	\$9,056,610,000	1.46%	\$190,473,966	69.55%	46
Iowa	\$103,327	\$5,200,994,000	1.99%	\$109,384,632	94.46%	34
Kansas	\$95,619	\$4,713,216,000	2.03%	\$99,125,936	96.46%	32
Kentucky	\$260,391	\$4,875,928,000	5.34%	\$102,548,011	253.92%	2
Louisiana	\$246,250	\$6,708,850,000	3.67%	\$141,097,085	174.53%	4
Maine	\$40,341	\$1,576,818,000	2.56%	\$33,162,826	121.65%	13
Maryland	\$147,489	\$7,348,370,000	2.01%	\$154,547,141	95.43%	33
Massachusetts	\$290,189	\$11,195,841,000	2.59%	\$235,465,173	123.24%	12
Michigan	\$201,094	\$14,636,630,000	1.37%	\$307,830,079	65.33%	49
Minnesota	\$150,069	\$7,215,787,000	2.08%	\$151,758,723	98.89%	29
Mississippi	\$97,296	\$3,395,650,000	2.87%	\$71,415,565	136.24%	9
Missouri	\$195,004	\$8,374,011,000	2.33%	\$176,117,895	110.72%	19
Montana	\$32,506	\$1,201,377,000	2.71%	\$25,266,744	128.65%	10
Nebraska	\$40,494	\$2,842,416,000	1.42%	\$59,780,232	67.74%	47
Nevada	\$77,279	\$2,006,533,000	3.85%	\$42,200,371	183.12%	3
New Hampshire	\$40,037	\$1,854,690,000	2.16%	\$39,006,887	102.64%	27
New Jersey	\$257,910	\$17,364,958,000	1.49%	\$365,210,871	70.62%	45
New Mexico	\$34,929	\$2,063,449,000	1.69%	\$43,397,399	80.49%	43
New York	\$688,284	\$33,165,352,000	2.08%	\$697,516,636	98.68%	30
North Carolina	\$225,408	\$10,104,712,000	2.23%	\$212,517,109	106.07%	24
North Dakota	\$17,311	\$928,572,000	1.86%	\$19,529,249	88.64%	36
Ohio	\$325,865	\$15,031,578,000	2.17%	\$316,136,422	103.08%	26
Oklahoma	\$134,882	\$4,454,808,000	3.03%	\$93,691,232	143.96%	7
Oregon	\$64,295	\$4,129,762,000	1.56%	\$86,855,032	74.03%	44
Pennsylvania	\$433,370	\$18,897,430,000	2.29%	\$397,441,034	109.04%	22
Rhode Island	\$36,844	\$1,550,275,000	2.38%	\$32,604,587	113.00%	17
South Carolina	\$69,666	\$5,036,168,000	1.38%	\$105,918,097	65.77%	48
South Dakota	\$29,746	\$1,261,686,000	2.36%	\$26,535,131	112.10%	18
Tennessee	\$171,340	\$7,566,235,000	2.26%	\$159,129,165	107.67%	23
Texas	\$754,674	\$31,330,471,000	2.41%	\$658,926,362	114.53%	16
Utah	\$39,959	\$2,242,306,000	1.78%	\$47,159,027	84.73%	39
Vermont	\$17,931	\$999,561,000	1.79%	\$21,022,253	85.30%	38
Virginia	\$196,416	\$10,423,225,000	1.88%	\$219,215,911	89.60%	35
Washington	\$146,309	\$6,690,300,000	2.19%	\$140,706,951	103.98%	25
West Virginia	\$66,813	\$2,209,599,000	3.02%	\$46,471,150	143.77%	8
Wisconsin	\$103,806	\$7,811,098,000	1.33%	\$164,278,998	63.19%	50
Wyoming	\$13,878	\$657,638,000	2.11%	\$13,831,104	100.34%	28
National Average	\$169,538	\$8,061,139,627	2.10%	\$169,537,745		

the total tax receipts divided by total premiums written during a year. Note that Georgia's statutory rate is 2.25 percent, while the effective rate is much lower, 1.78 percent. This is among the lowest effective rates in the country.

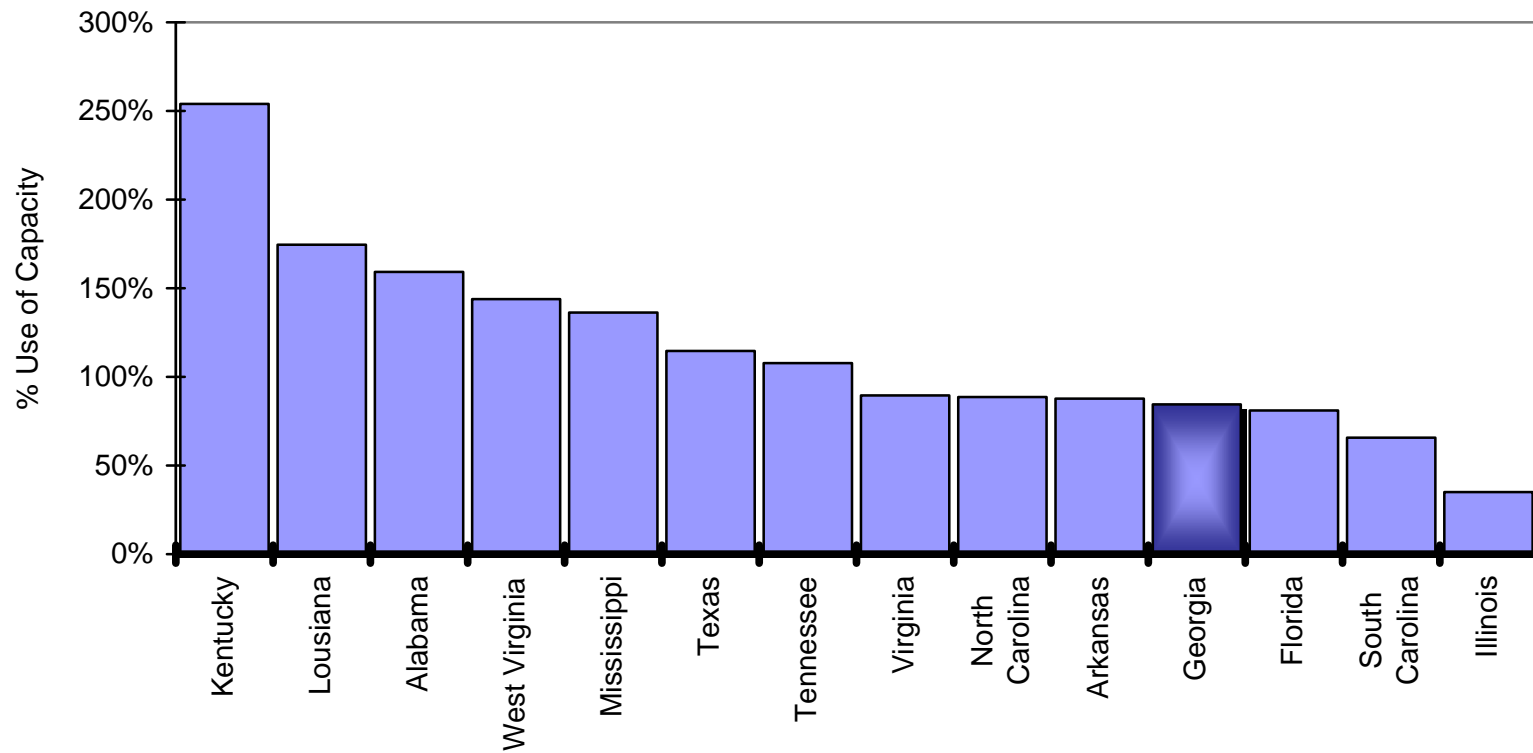
However, it is misleading for two reasons to think that the actual rate is low. First, due to abatements and deductions (discussed in more detail below), Georgia does not count as premium tax revenue certain life taxes and that are based on premiums collected by the state but dispursed to the local communities. These taxes are an additional 1.0 percent of the life premiums and are allowed as a deduction against the premium tax. There also is a local tax for the property-liability industry that is collected by the state that amounts to 2.5 percent of premiums collected by the state and turned over to the local governments. Since most states (with the notable exceptions of Kentucky, South Carolina and Alabama) do not have local premium taxes, the measured effective rate of taxation is distorted.

Another way to compare tax burdens across states is to use at a standardized tax base and a standardized tax rate to determine a standardized "capacity" for each state. Then comparing actual revenues received by the state for a particular tax to the standardized capacity for the state, one can then determine whether a state is over- or under-taxing its capacity.

The Advisory Commission on Intergovernmental Relations (ACIR) uses a standardized tax base to study state tax structures. For the insurance industry the standardized tax base is gross written premiums and the standardized rate is 2.10 percent (representing the U.S. average tax rate). Table 15 shows that in 1995, Georgia "under-utilized" its capacity relative to the national average, presumably because its tax rate is lower than that of the national average.

Table 15 should be interpreted with care, however, because, like the effective tax rate, the ACIR's methodology does not say anything about the distribution of the tax burden between foreign and domestic companies and between large and small companies, nor does it account for local premium taxes. Figure 4 shows Georgia's tax capacity relative to other southern states and

Figure 4
ACIR Premium Tax Capacity Utilization for
Southern States and Illinois



Illinois, which is included because it has a very large domestic insurance industry and does not tax the domestic industry with a premium tax. The figure shows that Georgia is at the lower end in terms of capacity. In terms of the level of the tax, Georgia appears competitive in the South, but this should be interpreted with care because it does not appear to include the local premium tax burden born by companies operating in Georgia, nor does it take into account the distribution of who ultimately pays the taxes.

The effective tax rate reported in Table 14 is not necessarily a good indicator of a tax burden as Georgia also has local premium taxes that are not included in the calculation. These local taxes are an additional 1 percent for life companies and an additional 2.5 percent for non-life companies. Further, the life companies can take a credit for their payments to local governments while the non-life companies do not have a similar credit. The last column in Table 14 shows the effective tax rate for all non-life companies writing business in Georgia, and includes all taxes, licenses, and fees paid to Georgia or its political subdivisions. As can be seen, Georgia's effective rate becomes significantly higher than the surrounding states when local taxes are included.¹⁶ In fact, only one state has a higher effective tax rate for the non-life industry, Kentucky, which also has substantial local taxes and fees in addition to the premium tax.

Tax Calculation

The tax due the state of Georgia is simply the tax rate times the tax base, minus any abatements (Box 2). The abatements, some of which are common to other states, are discussed below.

¹⁶ The data for this exercise came from the NAIC's Annual Statement Tapes for the Property-Liability (Non-life industry). Unfortunately, similar data were not available for the life insurance sector, so a life insurance industry effective tax rate could not be obtained.

1	Premiums Received
2	Premiums Returned and Dividends Paid
3	Taxable Premiums (line 1 – line 2)
4	Amount of Tax (line 3*2.25%)
	<i>Abatement and Deductions</i>
5	Investment Abatement 1% abatement if 25% of assets are invested in Georgia 1.75% abatement if 75% of assets are invested in Georgia
6	Retaliation Abatement for fire, windstorm, and lightning writings
7	License Fees to Local Government (Life, Accident & Sickness (Life, A&S) only)
8	Life and AS guarantee fund assessments
9	County and Municipal Taxes (Life, and A&S only)
10	Sum of Abatements (line 5 + line 6 + line 7 + line 8)
11	Premium Tax net of Abatements and Deductions (line 3 – line 10)

Box 2. Georgia Premium Tax Calculation

From premiums received the taxpayer is allowed to deduct premiums returned to the policyholder and any dividends paid to the policyholder.¹⁷ (This is a common provision for many states.) The resulting taxable premiums are taxed at a rate of 2.25 percent.

A number of abatements or deductions exist which offset from the taxes due. The first is the investment abatement. If an insurer invests one fourth of its assets (net of U.S. governmental obligations) in certain qualified Georgia assets under O.C.G.A. 33-8-5, the insurer can reduce its effective tax rate from 2.25 percent to 1.25 percent. Further if the insurer invests seventy-five percent or more in these same assets, the insurer can reduce its effective rate to 0.5 percent.

¹⁷ Mutual insurers generally pay dividends to policyholders. In a mutual insurance company, the policyholder is an actual equity holder of the firm. Thus, dividends can represent either overpayment of premiums or a return on the policyholder's investment. For a discussion of this issue see Black and Skipper (1994: 1029). For a general discussion of the ramifications of being a mutual or a stock company see Mayers and Smith (1988).

A few other states also have these investment abatements, for example, Texas and Mississippi. The problem with these investment abatements is that they may be a disguised domestic preference since only a domestic company is likely to be able to place the required amount of assets within the state. Some evidence of this assertion is provided below.

A second abatement authorized in O.C.G.A. 33-3-8-7 is allowed for property and liability companies writing coverage for fire, windstorm, and lightning damage in Georgia and that are subject to another state's retaliatory tax provision.¹⁸ This is not a common provision, and is generally employed by "high tax" states to soften the blow of retaliatory taxes. Mississippi has a similar credit for its domestic industry. If a Mississippi domestic pays retaliatory taxes to another state, then that domestic company can reduce its Mississippi premium taxes by the amount of the retaliatory tax paid to other states. In the case of Mississippi, the credit applies to all insurance written by domestic companies (both life and non-life), while in Georgia only certain non-life lines are eligible for this credit.¹⁹

A third abatement allows deductions for license fees paid to local governments for life, health, and HMOs, and is authorized in O.C.G.A. §33-8-8. These license fees vary from municipality to municipality and are graduated based on the size of the municipality. The license fee for each office in a municipality ranges from \$15 to \$150. Most states do not allow an offset against their premium taxes for these fees. The property-liability industry does not receive a similar abatement. Again, the practice in Georgia provides only part of the industry with a benefit.

The fourth deduction is authorized by O.C.G.A. §33-38-22 and allows a deduction for payments made to the Georgia Life, Accident and Sickness Guarantee Fund (GLASGAF). This

¹⁸The retaliatory tax is discussed further below.

¹⁹ This credit for retaliatory taxes paid essentially shifts the burden of the retaliatory taxes to other non-insurance tax-payers within the state, assuming that the state will make up the shortfall from the credit from other tax-payers.

fund has the legal authority to assess all life, and accident and sickness (A&S) companies if a life or A&S company operating in the state of Georgia fails and has insufficient assets to pay off its Georgia liabilities. Any assessments made by this fund are deductible from the premium tax due. Most states allow for a similar deduction for payments to state guarantee funds. However, if a Georgia property-liability company failed, the assessment to cover its losses would not be deductible under current law. Many states allow these assessments against property-liability companies to be deducted from the premium taxes. Again, Georgia discriminates against the property-liability industry.²⁰

Finally, the life, A&S, and health maintenance organization (HMO) companies are allowed to deduct any county and municipal taxes; these are discussed in more detail below. It should be noted that this abatement is not available to the property-liability industry. Many states do not have these additional taxes and those that do are likely to provide similar treatment for the life insurance and non-life industries within their states.

The sum of the abatements is deducted from the total domestic premium tax due to the State of Georgia. For domestic companies this is the end of the tax calculation, but for foreign companies, a further retaliatory tax may be imposed depending on the tax policy of the foreign company's home state.

Retaliatory Tax

The retaliatory tax is authorized under O.C.G.A. §33-3-26 and essentially penalizes a company domiciled in a state with a tax rate that is higher than that of Georgia. The operation of the retaliatory tax can be seen in the following example (Box 3).

²⁰ The cost of expanding this abatement to property and liability companies would be relatively small, as there were only \$4.1 million in guarantee fund assessments in 1995. However, this is a potentially volatile abatement that could change from year to year.

1	Premiums in Georgia	\$1,000.00
2	Georgia's tax rate	2.25%
3	Premium Tax due Georgia from Hawaiian company (Line 2 * Line 1)	\$225.00
4	Hawaii's tax rate applied to a hypothetical Georgia company operating in Hawaii	4.265%
5	Total Amount a hypothetical Georgia company would pay to Hawaii if it had same premiums as Hawaiian company operating in Georgia (Line 4 * Line 1)	\$426.50
6	Retaliatory Tax due Georgia is Line 5 – Line 3	\$201.50

Box 3. Calculation of Retaliatory Tax

Suppose, for example, a Hawaiian company was doing business in Georgia and wrote \$1000 in received premiums. Its premium tax bill for Georgia would be (assuming no deductions) \$225. The retaliatory tax is calculated in the following way. Suppose a Georgia company wrote \$1000 worth of business in Hawaii. Since Hawaii has a 4.265 percent premium tax, the firm would pay \$426.50 to the State of Hawaii. The retaliatory tax due to Georgia is the difference between what the Hawaiian company paid to Georgia and what a hypothetical Georgian company would pay to the State of Hawaii. In this case, this amounts to \$201.50, which is line 5 less line 3 in Box 2.

Exclusions from the Tax Base

There are a number of important exclusions from the premium tax base in Georgia. The first exclusion is for annuities. Annuities are contracts where the annuitant provides the insurance company with an amount of money, and in exchange the insurance company provides periodic payments for a specified period of time. Since annuities are often associated with retirement savings, they are exempt from taxation in most states, and even among those states that do tax annuities, most allow for an exemption for annuities provided as part of an IRS qualified retirement plan. Table 13 shows the tax policy on a state-by-state basis. The estimated

cost to the State of Georgia of exempting annuities in 1995 was approximately \$13 million, assuming that all annuity considerations would otherwise be taxed at the maximum rate.

The second exemption from the tax base is federal reinsurance premiums on crop insurance. In 1993, the Tenth Circuit U.S. Court of Appeal held that the states were preempted from taxing these premiums because they were part of a federal program.²¹ Although binding on only those states in the Tenth Circuit, most states abide by the decision.

Finally, a potentially large amount of insurance goes untaxed because it is in the form of self-insurance. There is no accurate measure of the amount of self-insurance in existence. It usually is used to fund medical insurance or workers compensation insurance. In times of both rising medical insurance expenses and workers compensation insurance expenses, business could avoid the premium tax by combining with others to form self-insurance pools, or to provide the coverage themselves. Self-insurance purchases are likely to be cyclical. When prices in the traditional insurance market increase, buyers who can take advantage of self-insurance will do so, thus avoiding the premium tax. When prices of insurance decrease, consumers may switch back to the market, but some will stay with their self-insurance. Thus, high volatility in certain lines may cause greater and greater reliance on self-insurance over private markets. This has the effect of reducing premium tax revenue growth over time.

Some states also provide for an exemption for health insurance from the premium tax for certain types of companies such as Blue Cross/Blue Shield licensees or other non-profits (Table 12), but Georgia does not. However, since an accident and sickness company can be organized as a property-liability company or as a life and health company, there is a strong tax incentive to write as a life and health company as the life and health companies are allowed a deduction for

²¹ *State of Kansas, ex rel. Todd v. United States*, 995 F. 2d 1515 (10th Cir. 1993).

premium taxes paid to local governments, while the property-liability companies are not allowed this deduction.

Fire and Surplus Lines Taxes

Fire insurance is subject to a higher tax rate than other lines of coverage in order to cover the activities of the State Fire Marshall (who is also the Insurance Commissioner). Many states tax fire premiums differentially (Table 10) due to the historical link between property, fire insurance, and municipal fire protection which was the basis for the premium tax on fire insurance. Georgia's fire insurance premium tax rate is an additional 1.0 percent on premiums. Many states do not tax fire insurance differentially, but in those states the average premium is about 3.5 percent. In addition to Georgia, other southern states using this tax include Arkansas, Kentucky, Louisiana, North Carolina, Mississippi, and South Carolina.

Excess and surplus insurance is also subject to differential taxation in many states. Surplus insurance is employed when an entire portion of coverage is outside of the so-called standard market. This occurs when the traditional insurer will not insure the risk due to its underlying risk characteristics. Excess insurance is for those situations when a primary carrier can not cover all of a particular customer's risk; a partner is brought in to cover the excess. In many cases the excess or surplus lines carrier may not have a license in the state, and thus, the state may charge a higher premium tax. Coverages falling into either the excess or surplus lines categories are coverages for seemingly exotic needs such as auto racing liability, strike insurance, oil pollution liability coverage, and dramshop liability coverage. Georgia's tax rate on these coverages is 4.0 percent, which is higher than the national average of 3.43 percent.

Alternative Taxes on Insurance: The Income Tax

A number of states have both an income tax and a premium tax (Table 11). Two states (Oregon and Illinois) tax their domestic industry solely with an income tax. The remainder of the states with an income tax generally allow a credit for income tax payments against the premium tax.

The federal government also employs an income tax on the insurance industry. Thus, the major reason (simplicity) for employing a premium tax is diminished. A state could (and a number of them do) take the federal adjusted gross income (AGI) and allocate a portion of the AGI to the state; generally this is done by taking the premiums written by the firm in the state as a percentage of the total premiums written by the firm in the U.S. The resulting amount is subject of the state's tax rate.

The income tax would likely bring in less revenue than the premium tax because the income tax base is much smaller and the income tax rate is not that much higher. Generally, net taxable income will be less than total premiums written within a state. Other financial institutions generally pay an income tax and therefore pay less than insurance companies. Thus, horizontal equity is a concern here as like taxpayers are treated differentially.

One way of comparing the income tax and premium tax is to hypothetically assume that the insurance industry pays an income tax, and then determine the income tax rate required to bring in the same amount of revenues generated by the premium tax. This is not a trivial exercise, but Price-Waterhouse (1994) undertook this study for the state of Ohio. The results presented here are descriptive and not meant to imply what the case would be in Georgia, but one can see the order of magnitude of the difference in the two taxes. The Price-Waterhouse study calculated the apportioned income tax due Ohio using the Federal definition of a tax base for the life and non-life industries. For the period 1987 to 1992 the effective tax rate on income neces-

sary to generate the same revenue as the premium tax ranged from 14 percent to 21.2 percent. In contrast, the corporate statutory income tax rate in Ohio was 5.1 percent on the first \$50,000 of net taxable income and 8.9 percent on the amount above \$50,000, while it had a 2.50 percent premium tax rate. Georgia, in contrast, has a 6 percent general corporate income tax rate and has a 2.25 percent tax rate for premiums. The implication here is that the premium tax is assessed against total revenues, and this assessment could be a relatively large percentage of a company's profits.

Incidence of an Income Tax

Another difference between a premium tax and an income tax is the locus of the tax burden, or incidence. A premium tax, which is like an excise tax, is likely to be born by the purchaser of insurance through higher prices rather than by employees or capital owners. This is especially true for compulsory products like auto insurance or quasi-compulsory insurance like homeowners insurance. There are no close substitutes and the customer must have the coverage to obtain an auto license tag or a home mortgage. Thus, the consumer will bear most of the burden. To the extent that the demand for the insurance product is sensitive to price and there are non-insurance products that offer similar contract terms and are not subject to the premium tax, capital and labor in the insurance industry bear the burden. This is because relatively higher taxes on these insurance financial products will cause consumers to purchase other non-insurance products lessening the demand for insurance company labor and capital. The eventual burden on capital and labor will depend upon the ability of the inputs to move to other industries. To the extent that the premium tax increases the demand for capital and labor in other financial service industries, the tax burden is reduced. To the extent that the mobility of labor to other industries is less than that of capital, the greater the burden will be born by labor and vice-versa.

The income tax, however, is a tax on capital. To the extent that all capital is taxed at an equal rate, then no capital owner can escape the tax by investing in something else. The effect on consumers and employees is less clear. For example, a tax on capital may cause the firm to substitute some labor for capital. Thus, the demand (and wages) for labor increases. However, since the cost of the products is now higher, the consumer has to pay a higher price for the product, so some of the burden is passed to the consumer. A study of the incidence of the U.S. corporate income tax on life insurers prior to the 1984 tax law change suggested strongly that the incidence of the income tax was born by capital owners (Stagliano (1979)).²² This implied that the tax on capital in the insurance industry was at a higher rate than in other industries. However, since the rewrites of the federal insurance corporate income tax for both the life and non-life industries, no further research has been conducted on the incidence of the corporate income tax for insurers.

The Pros and Cons of Premium Taxation

Why Use a Premium Tax?

As mentioned above, a premium tax is a relatively simple tax. In general, a company merely adds up its gross written premiums and applies a tax rate to determine the tax bill. This is a simple process for the company, and a simple tax for the state to administer and audit. In addition, the premium tax generally produces a steadily increasing source of revenue as personal income increases since insurance is a normal good.

²² The fact that capital might bear the burden of an income tax is likely to be unique to a certain portion of the insurance industry. Mutual companies are owned by the policyowners of a firm, but unlike traditional forms of ownership in stock companies, the ownership share is not transferable. The burden on capital will be greatest in mutual life insurance companies because the ownership interest is not transferable and the contract for life insurance is generally a life time contract. Thus, capital owners can not avoid the incidence of the tax after the purchase of the contract. During the period of Stagliano's study, mutual life insurance companies dominated the market. Today, mutuals are still the largest companies, but most entrants are stock companies and some large mutuals are de-mutualizing and becoming stock companies.

Another advantage of a premium tax to other taxes on insurance firms is that the states have a long history of using this tax and there have been few complaints. Alternatives such as the income tax are difficult (in theory) to implement. Thus, simplicity, historical inertia, and difficulty of implementation of alternative taxes are the major reasons to keep and use the premium tax.

Why States Should Not Use a Premium Tax.

Skipper (1987) outlines a number of reasons to avoid using a premium tax. First, the premium tax is regressive; meaning that the lower-income insured pay a higher percentage of their income in these taxes than do the higher-income insured. This is an example of how the premium tax violates the notion of vertical equity.

Second, since cash value life insurance can be a method of savings, a premium tax on cash value life insurance is a tax on savings, which can reduce the incentive to save or provide incentives for the consumer to purchase a savings product from another financial service provider.²³

Third, the premium tax is also varies with age, health status, risk classification, and occupation. For example, older consumers pay higher premiums for life insurance and non-group health insurance. The reverse is true for auto policies as young people are considered higher auto risks and thus pay more premium taxes relative to older drivers. In addition, insured who are in poor health or in hazardous occupations pay higher health and disability premiums relative to those in better health and less risky occupations. Finally, those who live in high risk areas, such

²³One should note, however, that earnings and gains accumulated inside a life insurance product are partially shielded from federal and state personal income tax. The basis of a life insurance policy is generally the amount of premiums paid. Thus, if a person paid premiums of \$10,000 per year for 10 years, the first \$100,000 of policy earnings are not taxable. Thus, the state collects an up-front tax on the savings component of life insurance product in exchange for future tax-free status.

as rural areas without nearby fire departments or areas more prone to natural disasters, will pay more in premium taxes since their premiums will be higher than those living in low risk areas.

Fourth, consumers who purchase small policies pay more taxes per unit of insurance than those who purchase larger policies. This is because premiums are set to cover the cost of the risk plus the cost of administering and maintaining the policy. This administration expense is a fixed cost, and for small policies its percentage of the premium is high relative to the larger policy. This makes the small policy (which contains a higher proportion of expense costs relative to risk costs) bear a larger per insurance unit cost of the premium tax.

Fifth, there are a number of insurance substitutes, most notably self-insurance, which are not taxed. In Georgia, this is more likely to be a problem for health insurance or workers compensation. A company could potentially reduce its health care expenses by 2.25 percent by self-insuring which could be a significant savings. The availability of tax-free self insurance may also cause insured to opt out of the insurance market in times of insurance shortages like that experienced in the liability lines during the mid 1980s. This can make premium tax revenues volatile since as premiums are bid up, consumers will reduce their purchases of insurance and self-insure.

Sixth, the premium tax also has problems when there is differential taxation between foreign and domestic companies. Under Georgia's tax law domestic and small companies may benefit from a lower effective tax rate through the capital investment abatement. Smaller insurance companies are not likely to be as efficient as larger companies because of the tremendous economies of scale in the insurance industry.²⁴ Thus, the abatement can protect inefficient firms from the competition in the free and open market. In addition, since capital and surplus is not

²⁴ See Grace and Timme (1992) who shows that only the largest 100 life insurers have exhausted economies of scale, and Cummins and Weiss (1993), who show that all except the very largest non-life insurers have significant economies of scale.

allocated, it benefits and encourages single state companies -- thus concentrating rather than spreading the risk.²⁵

Finally, the premium tax must be paid irrespective of whether the insurer earns a profit. This means the tax is especially burdensome for start-up firms and firms that are losing money. Georgia's investment abatement provision may mitigate against this effect as small companies and start-ups may be able to reduce their tax by investing in Georgia assets.

Examination of Georgia's Premium Tax

This section provides an examination of the incidence and aspects of the behavior of the Georgia premium tax. The first subsection looks at the incidence of the non-life portion of the premium tax and how the application of certain tax policies can effect the amount of tax actually paid by companies. We compare Georgia to southern states and other states of particular interest due to either a similar tax provision or the state's overall importance to the insurance industry. The second subsection is a simulation analysis of the Georgia premium tax and shows how the state's revenues change when various aspects of the premium tax structure are altered.

Empirical Evidence of the Incidence of Georgia's Premium Tax

The National Association of Insurance Commissioners (NAIC) requires insurers to file annual reports. The report for the property-liability insurer contains state-by-state information regarding the taxes and fees paid by insurers to a particular state. A simple regression was estimated using this and other information to determine how the effective tax rate is related to a number of factors, such as whether the company is domesticated in Georgia, its size, or whether it is a stock or mutual firm.

²⁵If these small companies engage in reinsurance to spread the risk, they are still inefficient if a larger company would not have to engage in similar activities.

Table 16 shows the state-by-state regressions of the effects of some tax preferences on the effective tax rates across states. We include in this analysis the southern states, some important insurance states, as well as some states having preferences like Georgia's. The dependent variable is the effective tax rate as measured by the total taxes, licenses, and fees paid to a given state for a company divided by the total premiums written by that company for that particular state. The intercept represents the average effective tax rate, all other variables set equal to zero. State of domicile is a dummy variable representing 1 if the company is domiciled in the state and 0 otherwise. "Small" is a dummy variable that is 1 if the total assets of the company are less than the mean sized company nationwide; in 1994, the mean was approximately \$290 million. Approximately 85 percent of all companies are considered small by this definition. "Small" is interacted with the state of domicile to take into account policies benefiting small domestics. Finally, some states may also have tax policies that differ between mutuals and stocks.

Looking at the first regression that shows Georgia's results we see that, all things equal, the mean effective tax rate is 5.4 percent. Looking across states in the south, we see that Georgia's rate is the highest. This is because of the inclusion of the local taxes and fees. Virginia has the lowest intercept at 2.6 percent. Looking, at all the states in the table, Georgia's rate is the highest. Recall from Table 15 showing the use of tax capacity across all the states, Georgia appeared to be under-utilizing its capacity. From the results in Table 16 evidence suggests that this is not necessary true. This result is due to the imposition of the local taxes on the non-life industry.

If the coefficient on the state of domicile is negative and statistically significant (denoted by *** or **), then, as in the case of Georgia, a domestic company has a lower effective rate than a foreign (out-of-state) firm. For Georgia, domestic firms have an effective tax rate which is 1.1 percentage points lower than foreign firms. Other states (Alabama, Kentucky, Louisiana,

Table 16. Regression Results for Various States for the Property Liability Industry. Dependent Variable is the Effective Tax Rate

Variable	Georgia'	Alabama'	Arkansas'	Flonda'	Kentucky'	Louisiana"	Mississippi'	North Carolina
Intercept	0.054*** (0.001)	0.042*** (0.001)	0.032*** (0.001)	0.0286*** (0.003)	0.033*** (0.001)	0.046*** (0.002)	0.034*** (0.000)	0.025*** (0.001)
State of Domicile	-0.011 (0.004)	.032*** (0.002)	~.003 (0.003)	0.036*** (0.014)	4).022*** (0.004)	~.017*** (0.004)	-0.001 (0.0012)	-0.002 (0.002)
Small	-0.009*** (0.002)	-0.001 (0.002)	-0.001 (0.001)	0 (0.006)	-0.002 (0.002)	-0.013*** (0.003)	-0.001 (0.001)	-0.001 (0.001)
Small*State of Domicile	0.001 (0.005)	0.004 (0.003)	---- (0.003)	-0.037** (0.017)	-0.002*** (0.006)	---- (0.006)	-0.012 (0.012)	0.001 (0.002)
Mutual	0 (0.000)	-0.001 (0.001)	-0.001 (0.001)	0.004 (0.006)	-0.01*** (0.002)	0.001 (0.003)	0 (0.001)	0.001 (0.001)
R2	0.07	0.39	0.01	0.01	0.15	0.08	0.09	0.002
Variable	South Carolina'	Tennessee'	Texas'	Virginia'	California'	Connecticut'	illinois'	Kansas
Intercept	0.042*** (0.002)	0.030*** (0.001)	0.028*** (0.000)	0.026*** (0.002)	0.023*** (0.008)	0.024*** (0.001)	0.023 (0.008)	0.044*** (0.002)
State of Domicile	-0.025 (0.021)	-0.018*** (0.001)	-0.001 (0.002)	-0.016*** (0.008)	0.002 (0.001)	0.029*** (0.002)	-0.013 (0.011)	0.022*** (0.005)
Small	-0.006 (0.004)	-0.003*** (0.001)	-0.005*** (0.002)	-0.001 (0.003)	0 (0.000)	-0.002 (0.002)	-0.002 (0.015)	-0.005 (0.004)
Small*State of Domicile	0.015 (0.022)	0 (0.002)	0 (0.000)	---- (0.003)	-0.001 (0.002)	-0.011*** (0.005)	0 (0.020)	---- (0.002)
Mutual	-0.004 (0.003)	-0.001 (0.001)	-0.004*** (0.001)	-0.001 (0.003)	0.001 (0.001)	0.002 (0.002)	0 (0.010)	-0.007*** (0.002)
R2	0.04	0.26	0.06	0.01	0.01	0.14	0.003	0.76

*Significant at the 0.05 level

Significant at the 0.10 level

Crable 16 Continued on next page)

Table 16 (Continued)

Variable	Massachusetts"	New Jersey"	New York"	Ohio"
Intercept	0.024*** (0.001)	0.039*** (0.001)	0.0311*** (0.001)	0.025*** (0.001)
State of domicile	-0.002 (0.003)	-0.019*** (0.001)	-0.002 (0.003)	-0.018 (0.001)
Small	-0.002 (0.001)	0.001 (0.003)	-0.005* (0.003)	-0.018*** (0.001)
Small*State of Domicile	0.035 (0.002)	0.014*** (0.005)	-0.001 (0.005)	-0.001 (0.001)
Mutual	0.004*** (0.001)	0.003 (0.003)	-0.002 (0.002)	0.003*** (0.001)
R2	0.03	0.07	0.014	0.52

Tennessee, Virginia, Kansas, Massachusetts, and New Jersey) also have significantly lower rates for domestics. In contrast, some states such as Florida and Connecticut have a tax policy that imposes significantly higher tax burdens on domestic companies.

The interaction between “small” and state of domicile is not significant in Georgia. Thus, there is no *additional* benefit to being a small Georgia insurer that is distinct from being small *or* being a Georgia company. The tangible benefit flows to Georgia domestics or relatively small companies. Florida, Kentucky, and Connecticut, however, have policies that benefit small domestics. Finally, mutuals are advantaged in Kentucky, Texas, and Kansas and disadvantaged in Massachusetts and Ohio.

States like California appear to have a neutral tax policy in the sense that the variables used in these regressions are not significant. One might draw a similar conclusion about, but Illinois does have an explicitly discriminatory tax. The coefficient on state of domicile is not significant for Illinois, most likely because (1) most of the property liability business is written by Illinois companies, and (2) many companies may attempt to set up Illinois domestic subsidiaries to avoid paying the discriminatory tax.

Georgia Premium Tax Analysis

This section employs a simulation analysis to obtain simple descriptive analysis of potential changes in various provisions of the Georgia Premium Tax Law. The effects here are meant to estimate the magnitude of the change in tax revenue that would accompany a change in the structure of the premium tax.

The simulation considers 9 possible cases. The first one is the base case, representing the current tax structure in Georgia for the life and non-life industries. The other simulations change provisions of the tax law. For example, Simulation 2 limits the abatement that insurers can obtain. Simulation 3 assumes that both the life and non life firms pay the same tax rate of 2.00

percent, while simulation 4 sets this rate at 2.25 percent. Simulation 5 allows both the life and non-life companies to deduct local taxes, in contrast to Simulation 1 which allows only the life industry to take this deduction. Simulation 6 assumes an effective tax rate of 1.25 percent to domestics (resulting from a limited abatement), and allows all local taxes to be deducted. Simulation 7 uses a uniform tax rate of 1.75 percent, while Simulation 8 removes the local tax deduction and lowers the rate on premiums to 1.00 percent. Finally, Simulation 9 assumes a zero tax rate to show the effect of an inflow of retaliatory tax collections on Georgia revenues.

First, however, we must examine the underlying assumptions of the simulation.

Assumptions

A number of simplifying assumptions were employed to construct the simulation:

1. All domestic companies were assumed to be able to take full advantage of investment abatement, while no foreign company was assumed to be able to do so.
2. Retaliatory taxes were based upon 1995 tax rates for various lines of business, as shown by the NAIC Retaliatory Tax Guide.
3. It is assumed that local taxes collected on behalf of the state are not considered by other states in the retaliatory tax calculation. This is a conservative assumption in the sense that it will underestimate retaliatory tax payments to other states.

The results of the simulations are shown in Table 17. Simulation 1, the base case, assumes that foreign companies pay 2.25 percent in premium taxes, while all domestics are able to employ the investment abatement to reduce their rate to 0.5 percent. The first panel of Table 17 shows total taxes due (exclusive of abatements and credits not related to the investment abatement or retaliatory taxes). The second line (last column) shows the estimated total local tax collections for the life and health industry that are deductible for the life health industry, \$48.8 million. On the third line the net collection of the retaliatory tax from foreign companies is shown, \$4.76 million. The fourth line shows the total tax collected by Georgia (excluding

Table 17. Simulations of Georgia's Premium Tax**Simulation 1 Base Case**

Foreign Companies Taxed at 2.225 % and Domestic at 0.5%

	Life	PC	Health	Total
Total tax	\$ 61,304,075	\$ 139,455,355	\$ 49,894,191	\$ 250,653,621
-life local taxes				\$ (48,813,437)
retaliatory collections	\$ 537,940	\$ 4,084,194	\$ 138,088	\$ 4,760,222
Total to GA	\$ 61,842,015	\$ 143,539,548	\$ 50,032,279	\$ 206,600,405
ret paid	\$ 1,228,657	\$ 2,014,089	\$ 1,852,699	\$ 5,095,445

Simulation 2

Foreign Companies are taxed at 2.25% and all domestics are at 1.25% rate

	Life	PC	Health	Total
Total tax	\$ 62,381,251	\$ 146,270,757	\$ 50,869,063	\$ 259,521,071
-life local taxes				\$ (51,549,501)
ret coll	\$ 537,940	\$ 4,084,194	\$ 138,088	\$ 4,760,222
Total to GA	\$ 62,919,191	\$ 150,354,951	\$ 51,007,152	\$ 212,731,792
ret paid	\$ 1,228,657	\$ 2,014,089	\$ 1,852,699	\$ 5,095,445

Simulation 3

Assuming both Foreign and Domestic Pay 2.00%

	Life	PC	Health	Total
Total tax	\$ 56,726,653	\$ 138,095,965	\$ 46,372,349	\$ 241,194,967
-life local taxes				\$ (51,549,501)
ret coll	\$ 955,318	\$ 8,942,385	\$ 175,219	\$ 10,072,922
Total to GA	\$ 57,681,972	\$ 147,038,350	\$ 46,547,568	\$ 199,718,388
ret paid	\$ 679,880	\$ 1,161,126	\$ 645,669	\$ 2,486,676

Simulation 4

Assuming all companies pay 2.25%

	Life	PC	Health	Total
Total tax	\$ 63,817,485	\$ 155,357,960	\$ 52,168,893	\$ 271,344,338
-life local taxes				\$ (51,549,501)
ret coll	\$ 537,940	\$ 4,084,194	\$ 138,088	\$ 4,760,222
Total to GA	\$ 64,355,425	\$ 159,442,154	\$ 52,306,981	\$ 224,555,059
ret paid	\$ 1,228,657	\$ 2,014,089	\$ 1,852,699	\$ 5,095,445

Simulation 5

Assuming Domestic taxed at 0.005 and all local taxes are deductible & foreign companies are taxed at 2.25%

	Life	PC	Health	Total
Total tax	\$ 61,304,075	\$ 139,455,355	\$ 49,894,191	\$ 250,653,621
-local taxes				\$ (224,169,457)
ret coll	\$ 537,940	\$ 4,084,194	\$ 138,088	\$ 4,760,222
Total to GA	\$ 61,842,015	\$ 143,539,548	\$ 50,032,279	\$ 31,244,386
ret paid	\$ 1,228,657	\$ 2,011,271	\$ 1,852,699	\$ 5,092,627

Table 17 (cont.)

Simulation 6

Assuming Domestics are taxed at 0.0125 and local tax is deductible

	Life	PC	Health	Total
Total tax	\$ 62,381,251	\$ 146,270,757	\$ 50,869,063	\$ 259,521,071
-life local taxes				\$ (224,169,457)
ret coll	\$ 537,940	\$ 4,084,194	\$ 138,088	\$ 4,760,222
Total to GA	\$ 62,919,191	\$ 150,354,951	\$ 51,007,152	\$ 40,111,836
ret paid	\$ 1,228,657	\$ 2,011,271	\$ 1,852,699	\$ 5,092,627

Simulation 7

All Industry Taxed at 1.75%

	Life	PC	Health	Total
Total tax	\$ 49,635,822	\$ 120,833,969	\$ 40,575,806	\$ 211,045,596
-life local taxes				\$ -
ret coll	\$ 1,596,272	\$ 23,394,667	\$ 235,571	\$ 25,226,510
Total to GA	\$ 51,232,094	\$ 144,228,636	\$ 40,811,377	\$ 236,272,106
ret paid	\$ 354,679	\$ 562,165	\$ 267,737	\$ 1,184,582

Simulation 8

All Industry Taxed at 1.0%

	Life	PC	Health	Total
Total tax	\$ 28,363,327	\$ 69,047,982	\$ 23,186,175	\$ 120,597,484
-life local taxes				\$ -
ret coll	\$ 4,153,020	\$ 71,137,387	\$ 306,604	\$ 75,597,010
Total to GA	\$ 32,516,346	\$ 140,185,370	\$ 23,492,778	\$ 196,194,494
ret paid	\$ 1,228,657	\$ 2,014,089	\$ 1,852,699	\$ 5,095,445

Simulation 9

All Industry Taxed at 0%

	Life	PC	Health	Total
Total tax	\$ -	\$ -	\$ -	\$ -
-life local taxes				
retaliatory collections	\$ 8,004,679	\$ 137,388,651	\$ -	\$ 145,393,329
Total to GA	\$ 8,004,679	\$ 137,388,651	\$ -	\$ 145,393,329
ret paid	\$ -	\$ -	\$ -	\$ -

HMOs) while the fifth line shows the estimate of the domestic industry's tax paid to other states, \$5.095 million.²⁶

Simulation 2 is similar to simulation 1 except that the domestics can only obtain an abatement to reduce their effective rate to 1.25 percent. Because information regarding the companies' investments in Georgia are not actually known from publicly available data, simulations 1 and 2 effectively bracket the resulting tax revenue changes. The difference in revenue to the state of Georgia is approximately \$65 million and appears to come mostly from the property-liability industry.

Simulation 3 assumes that both foreign and domestic companies pay 2.00 percent. Compared with Simulation 1, the net positive revenue change is \$52 million, or 35 percent of the simulation 1 total. Simulation 4 assumes that all taxpayers face a 2.25 percent rate. Tax revenues increase by \$75 million, or 51 percent. Retaliatory taxes collected from foreign firms fall in Simulation 3 by almost one-half, while they do not change in Simulation 4.

Simulation 5 is similar to simulation number 1, except for that all local taxes paid by all companies are deductible. This dramatically reduces the total taxes collected by Georgia. Simulation 6 results in domestic companies paying 1.25 percent (a limited abatement), and allows for local taxes to be deducted. Revenues in this case are slightly higher than in Simulation 5.

Simulation 7 has the entire industry taxed at 1.75 percent (i.e., matching Florida's rate). In this simulation retaliatory taxes dramatically increase. Simulation 8 taxes all companies at 1.00 percent, which would be among the lowest tax rates in the nation, and allows no local tax deduction. Finally, Simulation 9 has a zero percent rate for the entire industry and no local tax deduction. Georgia would collect approximately two-thirds of its base case (Simulation 1)

²⁶ It should be noted that this simulation does not account for the effect of the local tax on the retaliatory tax calculation. The amount of retaliatory tax paid to other states is therefore understated.

revenues through the operation of the retaliatory tax only. One should note that in actuality (with the zero tax rate and no local tax deduction), the insurance industry would still pay 1.00 (life and accident and sickness) and 2.5 percent (property-liability) to local communities. While Georgia's property-liability rate is among the higher rates, the life rate is among the lower rates in the U.S.

Economic Development: The Ideal Use of Tax Incentives

Recently, many states have attempted to encourage economic development by providing tax breaks or subsidies to particular industries and firms as incentives for companies to locate or create jobs within the state. A recent study (Ihlanfeldt, 1994) examined the economic development tax incentives in Georgia. The report examined each of Georgia's explicit economic development policies. It is interesting to note that the insurance premium tax investment abatement is not mentioned in this study. Employees of the Department of Insurance believe, however, that economic development is the purpose behind the tax. According to the author of the above report, the Georgia economic development authorities were not aware of the tax abatement.

From a review of the literature, Ihlanfeldt finds a number of principles regarding promoting economic development through tax policy. The insurance premium tax investment abatement will be examined in light of these principles.

The Georgia insurance tax investment abatement appears to be available to all insurers. However, to be a creditable program, it should be available in some form to all companies, financial as well as non-financial. Furthermore, even though it appears to be available to all insurers, one should question the ability of large interstate corporations to take advantage of the abatement. It would be imprudent for a large company to invest such a large percentage of its

assets in Georgia. This “imprudence” may generate a regulatory solvency review of an insurer attempting to minimize its tax liability.

It is not clear how the effect of the insurance investment abatement should be measured, but two possible methods come to mind. The first is to consider additional incorporation of insurers in Georgia. More insurers may be associated with increased employment. If the abatement subsidizes labor, we may see companies attempting to start up in Georgia. Figure 5 shows the number of domestic companies over time for both the life and non-life sectors.

The non-life property liability industry has a somewhat erratic pattern (Figure 5), but the number of companies increased by 10 over the period. For the life industry, we see a modest decline starting in about 1989. In fact, in 1995 the number of companies (25) is the same as in 1955.²⁷ It is likely that with further consolidation in the insurance industry, the number of companies nationwide will fall.

Figure 6 shows the ratio of companies in Georgia to the total number of companies nationwide from 1974 to 1994. The Georgia non-life industry is cyclical, but has an 1994 ratio approximately equal to the 1974 ratio. The life insurance industry ratio declines at a modest rate. Both figures imply that the effect of the investment abatement is minimal when measured by the number of companies domesticated within Georgia.

Superficially, the tax law will allow all companies to take this investment abatement, but as the regression results in Table 16 showed, the benefit appears to be enjoyed by small and domestic companies.

The second measure of the effect of the abatement is to consider the number of jobs created. However, the abatement is a capital subsidy, not a labor subsidy. If the objective is to promote jobs, then a jobs (or wage) credit would be a better policy. Some states, such as Kansas,

²⁷See ACLI (1966) *Life Insurance Factbook*.

Figure 5
Life and Non-Life Companies Domesticated in Georgia, 1974-1995

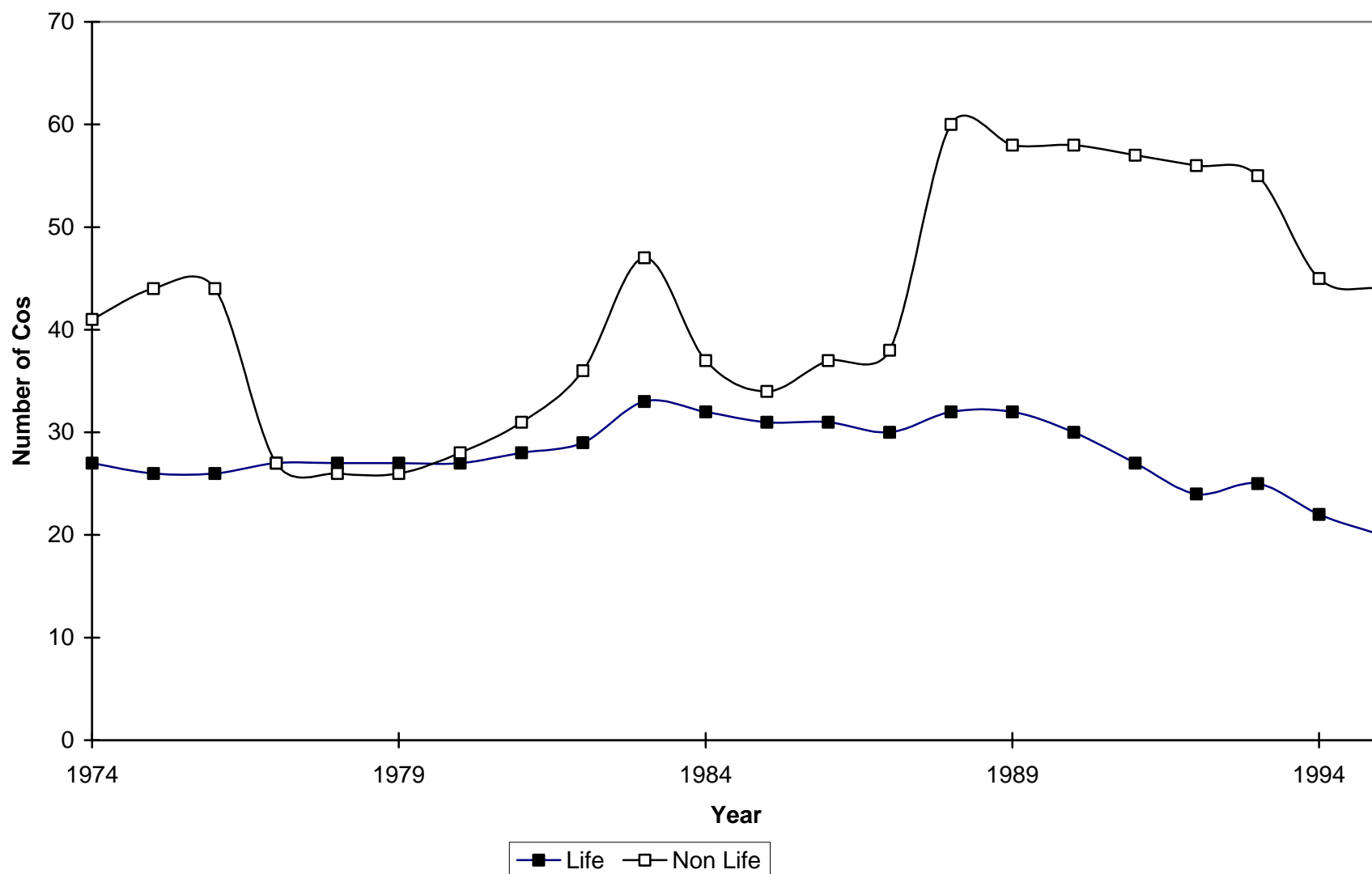
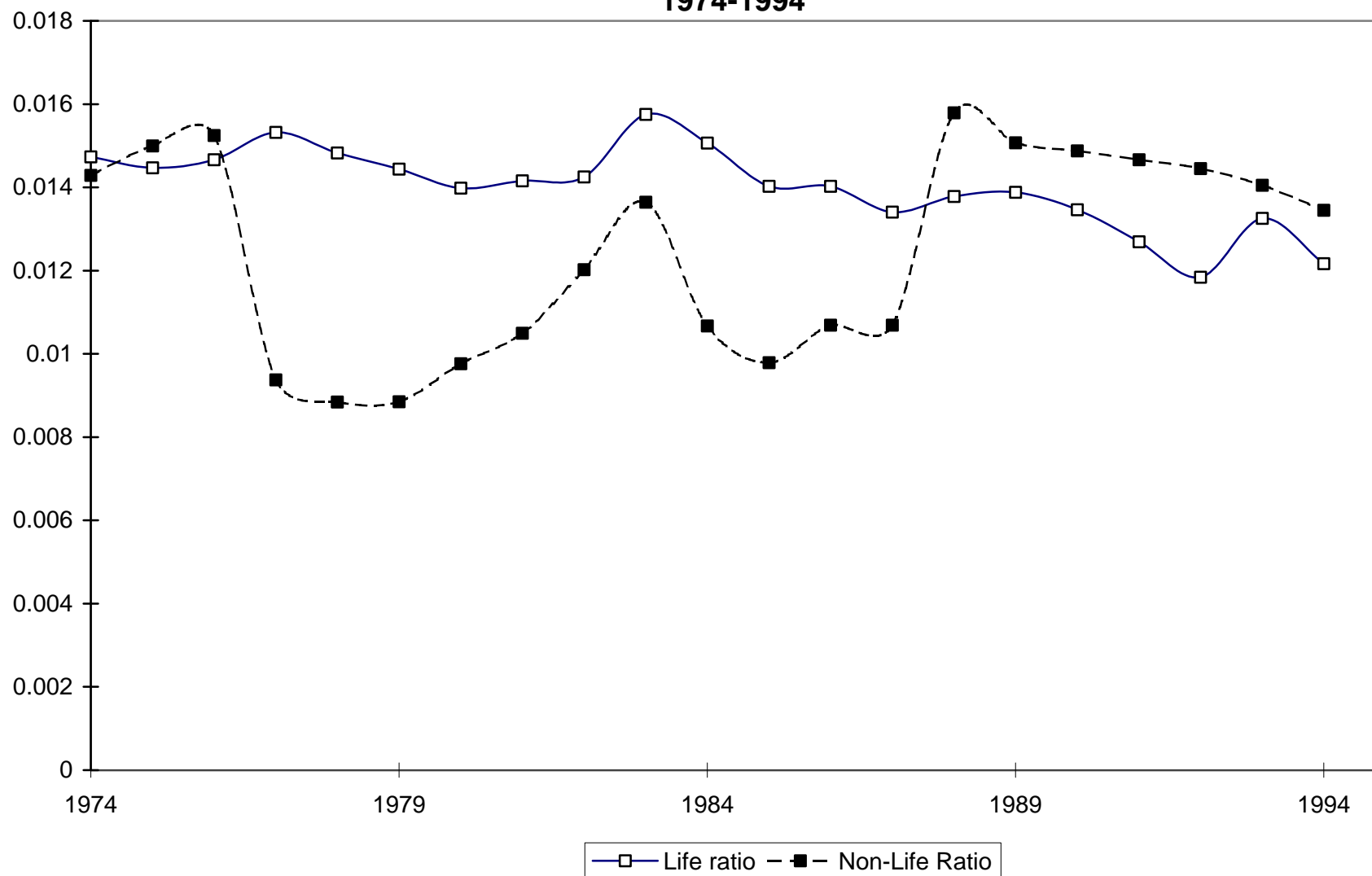


Figure 6
Ratio of Georgia Domestics to Total U.S. Companies for Life and Non-Life, 1974-1994



are currently considering a wage credit against the premium tax to provide incentives to locate in Kansas.²⁸

Ihlanfeldt also suggests that tax incentives should be targeted to firms in basic as opposed to non-basic industries. (A basic industry is one that exports outside the state, while a non-basic industry produces for the local market.) Georgia's non-life business wrote 13.3 percent of its business within the state while the life and health domestic industry wrote 5.3 percent of its business within the state (see Table 18). Thus, Georgia's insurance industry is a basic industry (since most of the Georgia premiums are written out of state) and could arguably be assisted through some sort of development initiative. However, to the extent that Georgia's tax rate is greater than the national average, this hurts Georgia companies operating nationwide are hurt because of the operation of the retaliatory tax. If Georgia desired to assist its insurance industry, a lower tax rate could be more effective than the abatement.

Domestic companies are affected by Georgia's relatively high tax rate. This burden is greater for the property-liability industry, which has to pay an additional 2.5 percent to the state (which is not creditable against the premium tax) on behalf of the counties and municipalities. This more than doubles the non-life tax rate on premiums written in Georgia. Thus, if a domestic property-liability company writes business in Florida, it will have to pay an additional 3 percent (4.75 percent minus the 1.75 percent Florida rate) to Florida in retaliatory taxes. This reduces the incentive for Georgia companies to write business outside the State of Georgia, as it will be effectively taxed at the Georgia rate everywhere it writes. The combination of local and state premium taxes makes Georgia's premium tax rate among the highest in the nation, and this is only partially offset by the retaliatory tax credit for firms writing fire, windstorm, and

²⁸ Florida has put in place a salary credit of 15 percent of the amount paid in wages and salaries against the premium tax. Colorado seems to have the most incentives (in the form of credits). The Colorado law provides credits for contributions to enterprise zone administrators, rehabilitation of vacant buildings, investments in new business in enterprise zones, and certain expenses for research and experimental activities within enterprise zones. (NAIC, 1996).

Table I8. Domestic and Foreign Premiums Earned by State, 1994

State	Non-Life Premiums			Life/health Premiums			Insurance Industry Premiums		
	Domestic	Total	Percent Domestic	Domestic	Total	Percent Domestic	Domestic	Total	Percent Domestic
Alaska	125.7	736.9	17.10%	0.4	473.4	0.10%	126.1	1,210.20	10.40%
Alabama	589.4	3,352.20	17.60%	368.6	2,523.70	14.60%	958	5,875.80	16.30%
Arkansas	118	2,162.20	5.50%	570.1	1,939.80	29.40%	688.1	4,102.00	16.80%
Arizona	860.7	34,861.70	43.20%	73.4	2,560.20	2.90%	934.1	6,638.10	14.10%
California	15,065.11	4,077.90	21.10%	1,428.80	19,791.40	7.20%	16,494.60	54,653.20	30.20%
Colorado	562.1	4,105.80	13.70%	103.9	2,856.30	3.60%	666	6,962.10	9.60%
Connecticut	792.1	4,359.40	18.20%	2,180.90	5,219.10	41.80%	2,973.00	9,578.50	31.00%
District of Columbia	45	813.6	5.50%	3.4	795.3	0.40%	48.4	1,608.90	3.00%
Delaware	322.4	1,151.20	28.00%	90.4	1,181.80	7.60%	412.7	2,333.10	17.70%
Florida	2,717.70	14,519.50	18.70%	1,963.20	12,438.00	15.80%	4,680.90	26,957.50	17.40%
Georgia	858.7	6,471.40	13.30%	280.1	5,329.80	5.30%	1,138.80	11,801.20	9.60%
Hawaii	500.4	1,620.00	30.90%	59.8	791.9	7.60%	560.2	2,412.00	23.20%
Iowa	775	2,516.00	30.80%	1,553.40	3,430.80	45.30%	2,328.30	5,946.80	39.20%
Idaho	295.1	1,078.90	27.30%	17.9	662.9	2.70%	313	1,741.80	18.00%
Illinois	6,930.10	12,077.00	57.40%	4,313.90	13,263.00	32.50%	11,244.00	25,340.00	44.40%
Indiana	2,052.10	5,738.20	35.80%	502.6	5,191.00	9.70%	2,554.60	10,929.20	23.40%
Kansas	421.1	2,438.70	17.30%	748.4	2,718.20	27.50%	1,169.50	5,156.90	22.70%
Kentucky	423.5	3,037.60	13.90%	211	2,151.60	9.80%	634.5	5,189.20	12.2%
Louisiana	439.6	4,246.40	10.40%	581.4	3,314.00	17.50%	1,021.00	7,560.40	13.50%
Massachusetts	3,739.20	7,843.20	47.70%	871.9	4,682.80	18.60%	4,611.00	12,526.00	36.80%
Maryland	587.4	4,568.20	12.90%	200.8	3,436.30	5.80%	788.2	8,004.50	9.80%
Maine	333	1,166.20	28.50%	36.9	746.7	4.90%	369.9	1,912.90	19.30%
Michigan	4,419.90	9,773.40	45.20%	987.6	7,002.60	14.10%	5,407.50	16,776.10	32.20%
Minnesota	917.2	4,857.00	18.90%	699.6	3,602.80	19.40%	1,616.80	8,459.80	19.10%
Missouri	579.3	4,994.90	11.60%	538.6	4,236.90	12.70%	1,117.90	9,231.80	12.10%
Mississippi	320.1	2,030.40	15.80%	154.9	1,581.30	9.80%	475	3,611.60	13.20%
Montana	18.6	785.7	2.40%	0.3	563.5	0.00%	18.9	1,349.20	1.40%
North Carolina	917.9	5,602.90	16.40%	499.3	5,502.70	9.10%	1,417.20	11,105.60	12.80%
North Dakota	115.3	587.2	19.60%	19.8	501.2	3.90%	135.1	1,088.40	12.40%
Nebraska	360.7	1,671.90	21.60%	666	2,132.90	31.20%	1,026.70	3,804.80	27.00%
New Hampshire	201.7	1,204.00	16.80%	20.3	868	2.30%	222	2,071.90	10.70%
New Jersey	3,968.00	10,599.30	37.40%	1,641.90	8,943.20	18.40%	5,609.90	19,542.50	28.70%
New Mexico	140.2	1,434.60	9.80%	0.1	1,201.50	0.00%	140.4	2,636.10	5.30%
Nevada	22.7	1,412.10	1.60%	16.5	952.8	1.70%	39.2	2,365.00	1.70%
New York	5,043.90	20,741.80	24.30%	9,132.90	16,227.10	56.30%	14,176.80	36,968.90	38.30%
Ohio	5,507.30	10,055.20	54.80%	966.3	8,905.40	10.90%	6,473.50	18,960.70	34.10%
Oklahoma	421.4	2,835.40	14.90%	193	2,144.10	9.00%	614.3	4,979.50	12.30%
Oregon	806.2	3,093.20	26.10%	229.4	2,022.80	11.30%	1,035.60	5,116.00	20.20%
Pennsylvania	4,260.00	13,099.60	32.50%	559.9	8,593.50	6.50%	4,819.90	21,693.10	22.20%
Rhode Island	291.4	1,203.30	24.20%	26.7	670.1	4.00%	318.1	1,873.50	17.00%
South Carolina	723.8	3,218.90	22.50%	178.8	25,121	7.10%	902.6	5,731.10	15.70%
South Dakota	63.2	723.7	8.70%	12	683.7	1.80%	75.2	1,407.40	5.30%
Tennessee	626.2	4,400.20	14.20%	371.2	3,854.60	9.60%	997.3	8,254.80	12.10%
Texas	7,031.20	18,343.40	38.30%	6,183.90	17,662.80	35.00%	13,215.10	36,006.20	36.70%
Utah	252.7	1,543.10	16.40%	299.7	1,333.70	22.50%	552.4	2,876.80	19.20%
Virginia	192.5	5,253.00	3.70%	1,933.30	6,265.00	30.90%	2,125.80	11,518.00	18.50%
Vermont	123	695.8	17.70%	25.2	373.3	6.70%	148.2	1,069.10	13.90%
Washington	1,208.00	4,589.00	26.30%	644	3,782.10	17.00%	1,852.00	8,371.10	22.10%
Wisconsin	2,217.70	4,817.30	46.00%	1,088.00	4,000.10	27.20%	3,305.70	8,817.40	37.50%
West Virginia	38.4	1,333.80	2.90%	3.8	1,074.60	0.40%	42.2	2,408.40	1.80%
Wyoming	26.9	394.2	6.80%	0.4	323.3	0.10%	27.2	717.6	3.80%
Average			21.80%			13.50%			18.50%
Standard Deviation			13.50%			13.00%			10.8%
Minimum			1.60%			0.00%			1.4%
Maximum			57.40%			56.30%			44.40%

lightning coverage, as described above. Georgia companies are therefore at a development disadvantage because of the relatively high premium tax rate.

Conclusions and Potential Reforms

The structure of the Georgia insurance tax can be analyzed using the criteria outlined above: neutrality, equity, simplicity, and obsolescence. This section examines the premium tax point by point, and examines the possible reform options.

Equity

In terms of equity the premium tax is regressive, and may be especially burdensome on certain types of policyholders. Low-income consumers pay more in premium tax as a percentage of their income than high-income consumers. The regressivity depends in part on the type of policy (life, health or non-life). For example, high-risk consumers will pay more premium tax per policy than low risk consumers. This is because the tax is a percentage of the policy premium. Ideally, all things being equal, it is the high risk and the low income consumer that would benefit the most from having insurance coverage, yet the tax policy is designed to make it more expensive for these particular consumers.

Neutrality

The premium tax violates neutrality. The direction of the violation is not clear, especially when examining the tax policy related to savings products. These products are sold by a number of different financial service providers. For example, one could purchase a life insurance policy that has variable interest earnings, which is a bundled policy of insurance and a savings vehicle. One could buy a term insurance policy instead, and invest in mutual funds directly. At the state level, the term policy consumer pays a relatively low percentage of the value of the policy in

premium taxes (because the expense loadings for commissions and fees are lower than from other types of life insurance), and pays no premium tax on the amount provided to the mutual fund for investment purposes. An interest sensitive life insurance product, however, has higher expense loadings and the consumer would pay premium taxes on the contributions to the internal mutual fund. Without considering the implications of the federal taxation of these two products, there seems to be a bias towards the separately purchased term insurance and the mutual fund option rather than the interest sensitive product provided by a life insurer.²⁹

Elasticity and Stability

Historically, sales taxes, and by analogy premium taxes, were thought to be relatively income inelastic, i.e., as income increased by a given percentage, the premium tax revenues would also increase, but by a smaller percentage. Insurance tax revenues in Georgia have any unit elastic, i.e., as income increases by a given percentage, insurance tax revenues increase by an equal percentage (on average). Thus, in years of growing income, the insurance tax growth tracks well with increases in income.

However, the tax is not very stable. This is primarily due to the cyclical nature of the insurance industry. A profit tax would also suffer from this instability, as insurer's profits seem to be cyclical.

Economic Development

The evidence regarding economic development is mixed. It appears on the surface that the tax law assists in the development of the insurance industry in the state of Georgia; insurers

²⁹ Please note that this discussion does not deal with the implications of the tax treatment under the U.S. federal income tax. The biggest difference is that the build-up of income inside the insurance policy is tax deferred while the build-up of income within the mutual fund is subject to the capital gains tax portion of the income tax. This could be minimized by using a combination of term insurance and some tax deferred account such as a 4013(b), 401(k), SEP, or IRA.

can take the investment abatement if they invest in Georgia securities. The development provision, however, does not affect all firms equally, as many firms are not able to take advantage of the abatement. For example, the regression estimates show that small and domestic companies benefit in the non-life insurance industry. If development was a key reason for the tax abatement, then more money for development would be available if more companies could take advantage of the abatement. However, the abatement standards are so high (75 percent to get the full amount of the abatement) that prudent managers of insurers may not be able to invest that much in the securities of a single state.

Further, economic development is hindered by the operation of the retaliatory tax. Because Georgia's tax rate is relatively high, domestics are put at a disadvantage when operating in states with relatively low tax rates. This puts Georgia companies at a competitive disadvantage and could potentially stunt the growth of the Georgia industry. To the extent that insurance is sensitive to the price, the retaliatory tax provision (in other states) makes Georgia's insurance more expensive, all other things being equal. This reduces profit opportunities in other states and reduces the demand in the home office in Georgia for labor and capital. The incidence of the relatively high premium tax, in conjunction with the retaliatory tax in other states, thus falls on workers.

Obsolescence and Simplicity

These two categories are considered together because of the intrinsic relationship between the two in the premium tax. First, the premium tax is a very simple tax, but arguably is regressive and distorts consumer choice. Further, due to the effect of the relatively high premium tax and the operation of the retaliatory tax, the tax may hinder economic development. If there were no other types of taxes available for the industry, then one may argue that even with these faults the simplicity of the tax is a paramount concern. Simplicity is the primary reason the

tax was initially adopted. Today, however, there is another option that may solve some of the problems with this tax.

As shown in Table 11, a number of states currently employ an income tax. The definition of income for an insurance company is problematic, but an approach has been developed for the federal income tax. It would be *simple* to piggyback on the federal form, and in so doing the problems with the premium tax, as it is currently applied, would be reduced.

Reform Options

There are three separate reform options for the Georgia premium tax. First, removing the disparate treatment found in the various abatements in the premium tax would reduce differences in treatment between life and health companies and property-liability. The differences in abatements or deductions should be examined to determine whether the distinct treatments make sense. Either a removal of the abatements or an expansion to include the entire insurance industry might be in order.

Allowing deductions of all local taxes against the premium taxes for life and non-life companies would amount to a \$140 million (estimate for 1994) reduction in premium tax revenues.³⁰ The state collected approximately \$198 million in 1994 from the entire insurance industry in premium taxes. In contrast, if the state decided to remove the local tax exemption for the life industry, tax revenues would increase by approximately 25 percent.

Second, in conjunction with removing abatements, serious thought should be given to lowering the premium tax to the national average in order to reduce the negative impact of the retaliatory tax. Because of the operation of the retaliatory tax, Georgia domestic companies are

³⁰ These numbers are not based on the simulation results, but based on a calculation that assumes all foreign companies are assessed at a rate of 2.5 percent of premiums and the domestic companies are all eligible for the investment abatement, and like their life counter parts, exempt from the local tax. It is likely that this is too strong of an assumption and that the actual figure would be greater.

hindered from increasing their policy writings outside of the state because they face a higher tax rate. If the State of Georgia were to reduce the tax rate on insurance premiums, the rate paid by Georgia's companies outside of Georgia would also be reduced. This increases the competitiveness of Georgia companies outside of Georgia. Reducing the rate to 2.00 percent (which is slightly less than the national average effective tax rate in 1994), while keeping the distinction between deductions for local taxes for life and non-life companies, would cost the state about 6 percent of its premium tax and retaliatory tax revenues. However, as a result of this reduction from 2.25 to 2.0 percent, domestic companies reduce their retaliatory taxes paid to other states by almost 50 percent. (Compare Simulation 1 and Simulation 3.)

Third, serious consideration is merited for changing the structure of the tax from a gross revenue tax to one that is more in line with traditional corporations. This is a long-run reform option that will require serious thought because of the competition that will develop from various actors in the financial service industry. Banks, thrifts, and non-bank financial service corporations should be treated in approximately similar ways. The entire structure of the tax will require examination if people choose products solely because of their tax treatments. The revenue impact of changing from a premium tax to an income tax would be substantial, as the effective tax rate on premiums would be reduced dramatically.

A major problem with tax reform in the financial services industry is that it is easy to see differences between insurers, banks, and non-bank banks. It is much more difficult to see the similarities. However, with increasing competition among these industries, it will be easier to see the similarities. When banks start marketing insurance or when insurers start selling mutual funds, these differences will be immaterial. Thus, it is important to put all financial service taxes under scrutiny.

Tax policy of the financial service industry can affect the development of the state's industry for both foreign and domestic companies. Careful thought regarding the incentives provided by the tax system can be employed as a basis for a new set of incentives that can improve the development prospects of the entire financial service industry.

Bibliography

- Aaron, H. J. *The Peculiar Problem of Taxing Life Insurance Companies*, (Washington: The Brookings Institution) 1981.
- ACLI (1996) Life Insurance Fact Book (Washington: American Council on Life Insurance)
- Black, Kenneth and Harold D. Skipper, *Life Insurance* Twelfth Edition (Prentice Hall: Englewood Cliffs) 1994.
- Cummins, J. D. and M. Weiss, "Measuring Cost Efficiency in the Property-Liability Insurance Industry," 17 *Journal of Banking and Finance*, (1993): 463-482.
- Fox, William F. "Sales Tax: Current Condition and Policy Options," in *Taxation and Economic Development: A Blueprint for Reform in Ohio* (ed. by Roy Bahl) (Battelle Memorial Institute: Columbus) 1996.
- Grace, Martin F. and Julie L. Hotchkiss, "External Impacts on the Property-Liability Insurance Cycle," 62 *Journal of Risk and Insurance* (1995): 738-754.
- _____, and Martinez, Jorge, "Taxation of the Insurance Industry," in *Taxation and Economic Development: A Blueprint for Reform in Ohio* (ed. by Roy Bahl) (Battelle Memorial Institute: Columbus) 1996.
- _____, and Stephen Timme, "An Examination of Cost Economies in the United States Life Insurance Industry," 59 *Journal of Risk and Insurance* 72-103 (1992).
- _____, and Harold D. Skipper, Jr., "Illinois Discriminatory Premium Tax: Time for Repeal," Jr., 14 *Southern Illinois Law Review* 345-399 (1990).
- Inlanfeldt, Keith, "Tax Incentives for Economic Development in the State of Georgia," Staff Paper No. 2 of the Joint Study Commission on Revenue Structure, State of Georgia (Atlanta: Policy Research Center, Georgia State University) 1994.
- Joskow, Paul, "Cartels, Competition, and Regulation in the Property-Liability Insurance Industry," 4 *Bell Journal of Economics* (1973): 375-427.
- Martinez, Jorge "The Taxation of Financial Institutions in Jamaica," in *The Jamaican Tax Reform* (ed. by Roy Bahl) (Lincoln Institute for Land Policy: Cambridge Mass) 1990.
- Mayers, David and Clifford W. Smith, "Ownership Structure Across Lines of Property-Liability Insurance," 31 *Journal of Law and Economics* (1988): 351-378.
- Meier, Kenneth J., *The Political Economy of Regulation* (Albany: SUNY Press), 1987.
- Mooney, Sean and Larry Cohen (1991), *Basic Concepts of Accounting and Taxation of Property-Casualty Insurance Companies*, (New York: Insurance Information Institute).

- National Association of Insurance Commissioners (NAIC), *Retaliation Guide* (Kansas City: NAIC) various years.
- Price-Waterhouse, National Tax Service (1994), *Comparative Analysis of Taxation of the Insurance Industry in Ohio, 1987-1992*.
- Skipper, H.D, "State Taxation of Insurance companies: Time for a Change," 6 *Journal of Insurance Regulation* (1987): 121-142.
- _____, *The Taxation of Life Insurance Products in OECD Countries: Implications for Emerging Market Countries* (Paris: OECD) 1993 (Doc No. DAF/FE/AS/WD (93)).
- Stagliano, A. J. *The Incidence of the Life Insurance Company Federal Income Tax* (Homewood, Ill: R. D. Irwin), 1979.
- Stewart, Barbara, "Profit Cycles in Property-Liability Insurance," in E.D. Randall ed. *Issues in Insurance*, Fourth Edition, vol. 2 (Malvern, PA: American Institute of Property-Liability Underwriters), (1985): 111-174.

About the Author

Martin F. Grace received his Ph.D. in economics and his J.D. from the University of Florida in 1986. He is a Senior Research Associate at the Policy Research Center and is currently the Associate Director of the Center for Risk Management and Insurance Research. Professor Grace served on the staff of the Georgia Joint Study Commission on Revenue Structure and on the staff of the Commission to Study the Taxation and Economic Development for Ohio. His research interests include state taxation and regulation of the insurance industry. He is currently Associate Professor of Risk Management and Insurance and Associate Professor of Legal Studies in the Department of Risk Management and Insurance. He has published in insurance and economics journals and is currently an associate Editor of the *Journal of Risk and Insurance* and President of the *Risk Theory Society*.