BRIEFING

Florida TaxWatch

Repeal of Incentive for Insurers to Create Jobs in Florida Raises Concerns

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For at least the last 60 years, Florida's tax policy regarding insurance companies has provided a clear preference to companies that had a presence in Florida. Since 1988, that preference has been in the form of a credit against a company's insurance premium taxes of 15 percent of the salaries paid to Florida based employees. This preference was intended to promote the insurance industry in Florida, a desirable, clean industry with relatively high-paying jobs.

The 2013 Legislature is considering eliminating that insurance premium tax (IPT) credit, a move that would result in a tax increase of at least $230 million. This tax increase is intended to make up for the revenue lost by the proposed rolling back of some of the motor vehicle registration fees that were increased in 2009. The reduction in fees will decrease the annual cost of registering a motor vehicle by $12.

Florida TaxWatch commends the Senate for attempting to roll-back the motor vehicle fees but has concerns about the significant tax increase proposed to replace the lost revenue. The IPT credit repeal proposal came as a surprise, when the Chair of the Senate Appropriations Committee floated the idea a couple of weeks into the session. A week later, a proposed committee bill containing both tax provisions was before the Committee—which voted to submit it as a committee bill (SB 1832). Such a reversal of a long-standing tax policy should not be attempted hastily, before potential implications are fully assessed

History of Tax Preferences for Florida Insurance Companies

The state has always sought to promote the insurance industry in Florida through its insurance premium tax law. Prior to 1988, in order to encourage companies to come to Florida, the state completely exempted insurance companies that maintained their home offices in Florida from the 2 percent tax, and provided a lower tax rate (1 percent) for out-of-state insurance companies that had a regional home office in Florida. For nearly forty years Florida-domiciled insurance companies paid no premium taxes.

The 1987 Legislature, due to potential constitutionality concerns over equal protection, passed legislation to subject all insurance companies a 2.25 percent insurance premium tax. However, a 10 percent salary credit was added to retain an incentive for insurance companies to invest capital and people in

Florida. The effective date of the law was delayed until July 1, 1988, giving the Legislature another chance to revisit the issue. By 1988, the revenue estimate for the new law had increased significantly, resulting in larger tax increase than had been anticipated. Due to concerns that the law would have significant adverse effects on domestic insurers from increased state taxes and higher retaliatory taxes required by other states, the 1988 Legislature reduced the tax rate to 2 percent and increased the credit to 15 percent.

In 1988, Florida TaxWatch released a report entitled *New Law is a Balanced Approach to Taxing Insurance Premiums*. The report found that the new law was "a prudent and equitable way of dealing with the constitutional questions of the current law" while still providing an incentive for companies to base or maintain a presence in Florida.

In 1989, the insurance premium tax rate for all companies was reduced again, this time to 1.75 percent and the maximum credit cap was reduced from 75 percent to 65 percent of tax liability.

The credit only applies to non-licensed employees located or based in Florida. It does not apply to agents or independent contractors. Because the amount of all credits a company can take are limited, the average effective credit statewide is 10 percent of salaries.[1] In 2011, 15 percent of qualifying salaries totaled $320.5 million. However, the credit cap limited actual credits taken to $219.8 million. The current state forecast estimates $230.1 million in salary credits in 2012.[2]

1 Calculation by Florida TaxWatch, using data from Florida Senate Appropriations Committee, Bill Analysis and Fiscal Impact Statement for of SB 1832, March 29, 2013.

2 Florida Senate Appropriations Committee, Bill Analysis and Fiscal Impact Statement for of SB 1832, March 29, 2013.

Concerns with Repealing the Florida Salary Tax Credit

Insurance is a Target Industry in the State's Economic Development Efforts

The insurance industry has been selected as an area of focus in the state's economic development efforts. Florida has designated insurance industry as one of its Target Industries, making the industry eligible for tax incentives to create or retain jobs. Industries are chosen to be eligible for incentives because they have significant positive economic impacts on Florida, and they typically pay higher than average wages. These high wages allow for more employee disposable income, something important to Florida given the state's reliance on sales and use taxes. Also, corporate headquarters have been identified as one of Florida's "strategic areas of emphasis" for recruiting to Florida.

The Credit Provides an Incentive to Increase Jobs in Florida

This tax credit is another tool that Florida economic development professionals can use as a recruitment tool to bring companies to Florida. While there has been no research attempting to show a direct correlation between the tax credit and growth of the insurance industry in Florida, it is hard to argue that Florida's business climate is more attractive to insurers with the credit than without it. Taxes are usually not the primary reason a company decides to locate or expand in a specific state, but they are a factor and can serve as a tie breaker when differences in factors such as workforce and geographic location are not big enough to make a decision.

States are using incentives to recruit business. Just last month, North Carolina announced a deal with the major insurance company MetLife to bring 2,600 jobs to the state. MetLife was granted $94 million in state incentives if it meets employment and investment goals.[3] It should be remembered that many of the insurance jobs the Florida salary credit was created to encourage--such as administrative and call center positions—are very mobile and can be located just about anywhere.

Due to the existence of retaliatory taxes (see below), variations in premium tax rates across the nation are limited. Florida's premium tax rate is slightly below the national average. When there is little difference between tax rates, incentives such as tax credits can play a bigger role in creating a favorable tax environment. While there are other states—such as Arkansas and Kansas—that offer a salary credit, the number is relatively small, meaning Florida's credit still stands out as an incentive.

The Insurance Industry Pays Their "Fair Share"

Insurance companies are already taxed at a higher effective rate than most other businesses.[4] And as opposed to corporate income taxes, insurers pay premium taxes even if they do not make a profit. Corporations in Florida are subject to a 5.5 percent tax on net income. Because premium taxes are based on gross receipts, not net income, the tax base for insurers is proportionately much larger. Many states do not levy an income tax on insurance companies, instead relying on the insurance premium tax. Florida insurers are subject to both corporate income taxes (CIT) and insurance premium taxes, although the CIT they pay can be credited against their insurance premium taxes. The total salary and income tax credit a company can take is limited to 65% of their premium tax liability. Past studies have shown that insurance companies nationwide generally pay an effective tax rate that is much higher than states' CIT rates. An Ernst & Young study[5] in 2000 found that life insurance companies in Florida paid an effective tax rate of 12.8 percent, more than double the Florida's CIT rate. The Ernst & Young report estimated this resulted in annual "excess taxes" on life insurance companies alone in Florida of $113 million.

This disparity is highlighted when it is considered that Florida collected $703 million in insurance premium tax collections during 2012, while the state collected $1.8 billion in corporate income taxes.[6] Insurance companies remitted taxes equal to 39 percent of all the corporate income taxes remitted.

Premiums Will Likely Rise

Taxes are a factor all businesses consider when setting prices, and the price of insurance is no different. Insurance companies will likely increase premiums to make up for the $230 million annual tax increase. The impact on premiums should be quantified. The $12 a person saves when registering their vehicle could be offset by the higher premiums they pay.

Retaliatory Taxes

Nationwide, insurance premium taxation is unique in that it includes retaliatory taxes. When the effective premium tax rate in an out-of-state insurance company's home state is higher than Florida's effective premium tax rate, the out-of-state insurer pays a retaliatory tax to Florida. Conversely, Florida insurers pay retaliatory taxes to other states with lower premium taxes than Florida. The $230 million tax increase that would be caused by eliminating the salary credit would impact retaliatory taxes in two ways. First, Florida companies may face a larger tax increase than simply the loss of the credit if other states levy retaliatory taxes against them. Also, the amount

3 Frank Bracken, The News & Observer, MetLife to add 2,622 jobs in Cary and Charlotte, March 8, 29013.

4 Martin F. Grace, Georgia State University, *Excessive Taxation of the Life Insurance Industry: A Case for Reform,* December 23, 2003.

5 Quantitative Economics and Statistics Group of Ernst & Young LLP, *Excessive Taxation Of Life Insurance Companies In the 50 States,* State Tax Notes, August 12, 2002.

6 Office of Economic and Demographic Research, Revenue Estimating Conference General Revenue Fund, March 15, 2013,

of revenue Florida receives from the tax increase may be reduced by less retaliatory taxes remitted by foreign insurers. This impact needs to be assessed and quantified.

Tax System Stability

One characteristic of a tax system that businesses and relocation professionals find attractive is stability. The sudden change in a long-standing tax policy by repealing this tax credit may signal to other industries that the Florida Legislature may act hastily, without adequate time for a thorough study of the potential negative effects or time for a business to plan. This may have chilling effects on other industries when companies analyze political uncertainty as a factor in whether to come to, expand or stay in Florida.

Conclusion

The insurance industry has built up a significant presence in Florida over the years. Insurance carriers and related activities provide 183,812 full time and part-time employees in Florida in 2011. The personal income of these employees was approximately $11.8 billion. It is impossible to quantify accurately how much of the industry's growth in Florida is attributable the salary credit or the original domestic exemption, but they certainly played a beneficial role for the last 60 years and remains an active incentive in today's increasingly global and competitive market.

Florida TaxWatch commends Appropriations Chair Joe Negron and the rest of the Senate for increasing attention on the state's economic development incentives. The Senate is also moving legislation forward that would increase the evaluation and accountability of these incentives. A deliberate, comprehensive review of Florida's incentives is justified, but SB 1832 is not part of such a process. The legislation arose suddenly and is scheduled to be heard by only one committee—the Senate Appropriations Committee.

To achieve the goal of reducing the motor vehicle registration fees, the Legislature should look to further efficiencies and cost savings in the state budget, such as those recommended by the Florida TaxWatch Government Cost Savings Task Force and the legislative Office of Program Policy and Government Accountability.

When the legislature rewrote the insurance premium tax law back in 1988, it recognized the advantages of keeping an incentive to create and retain jobs in Florida. Along with encouraging growth of the industry, companies with a presence in Florida can be more closely monitored and regulated.

Reversing this long-standing policy of promoting the growth of one of the state's target industries, without fully evaluating the potential effects on both existing insurers and the growth of the industry in Florida should not be undertaken. Moreover, other concerns exist, such as the already relatively high rate of taxation of the insurance industry; the effect of retaliatory taxes on both state revenues and insurer taxes; the perception of the stability of our state tax structure; and—most importantly—the effect that a $230 million tax increase would have on the premiums Floridians pay and whether they would truly benefit—even with the motor vehicle fee rollback. These concerns suggest repealing the insurance premium tax credit for salaries paid to Florida employees is unwise.

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As an independent, nonpartisan, nonprofit taxpayer research institute and government watchdog, it is the mission of Florida TaxWatch to provide the citizens of Florida and public officials with high quality, independent research and analysis of issues related to state and local government taxation, expenditures, policies, and programs. Florida TaxWatch works to improve the productivity and accountability of Florida government. Its research recommends productivity enhancements and explains the statewide impact of fiscal and economic policies and practices on citizens and businesses.

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