



Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536



BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bills 985, 986, and 987 (as introduced 2-29-12)

Sponsor: Senator Mike Kowall (S.B. 985)
Senator Steven Bieda (S.B. 986)
Senator Jack Brandenburg (S.B. 987)

Committee: Finance

Date Completed: 3-20-12

CONTENT

Senate Bill 985 would enact the "Michigan Insurance Premium Tax Prepayment Act" to create a program under which an insurance company could purchase a premium tax prepayment (PTP) certificate that would entitle it to offsets against future premium taxes equal to 10% per year for 10 years. The bill would do the following:

- Require funds from the sale of PTP certificates to be deposited in the General Fund.
- Require the Department of Treasury to administer the program and approve or disapprove proposals to purchase PTP certificates.
- Limit the amount of approved PTP certificates to \$900.0 million.
- Require the Department to select a manager who would arrange for the sale of PTP certificates.
- Require the manager to have previous experience in marketing insurance premium tax credit obligations in at least five states, have over \$5.0 billion in equity capital, and meet other criteria.
- Provide that the tax offsets would be vested when the Department or manager received a prepayment from a purchaser in return for a PTP certificate.
- **Allow a purchaser to take the tax offsets against the premiums tax imposed by the Income Tax Act or the retaliatory tax imposed by the Insurance Code.**

-- Allow a purchaser to assign the certificate and the associated tax offsets to another insurance company.

Senate Bill 986 would amend Part 2 (Corporate Income Tax) of the Income Tax Act to allow the holder of a PTP certificate to claim a credit against the premiums tax under Part 2 or the retaliatory tax under the Insurance Code, equal to 10% of the purchase price of the certificate.

Senate Bill 987 would amend Section 476a of the Insurance Code to allow an insurer to credit against the retaliatory tax an amount equal to the credit the insurer could claim for a PTP certificate under Part 2 of the Income Tax Act if it were paying the tax imposed under Part 2.

The credits under Senate Bills 986 and 987 would be allowed for tax years beginning after 2013 and each subsequent tax year through 2023.

All of the bills are tie-barred.

Senate Bill 985

PTP Certificate Purchase; Tax Offsets

A "PTP certificate" be an instrument issued by the Department of Treasury or the manager that was issued in exchange for the prepayment of premium taxes by the purchaser and that provided a tax offset

equal to 10% per year of the face amount of the certificate. A "purchaser" would be an insurance company subject to a premium tax that elected to prepay its premium taxes by purchasing a PTP certificate. "Premium taxes" would mean the taxes imposed under Part 2 of the Income Tax Act or Section 476a of the Insurance Code.

Each purchaser that prepaid its premium taxes under the proposed Act would be entitled to tax offsets against future premium taxes equal to the face amount of the PTP certificates issued to the purchaser and evidencing the prepayment of premium taxes as provided under Section 645 of the Income Tax Act (which Senate Bill 986 would add) or Section 476a of the Insurance Code (which Senate Bill 987 would amend).

Tax offsets would be vested on the fund allocation date and would be available to the purchaser annually as provided in the proposed Act. (The "fund allocation date" would be the date on which the Department or the manager received a prepayment from a purchaser in return for the issuance of the PTP certificate that entitled the purchaser to receive an allocation of the full offset amount authorized by the Act.)

The Department or the manager could not approve more than \$900.0 million in the form of permitted PTP certificates.

Each purchaser of a PTP certificate could do one or more of the following:

- Take in respect of each premium tax year the tax offsets evidenced by the PTP certificate against premium taxes due for each such year according to the terms of the certificate as provided in Section 645 of the Income Tax Act or Section 476a of the Insurance Code, as applicable.
- Reduce its estimated and annual payments of liability for premium taxes for each year for which tax offsets were available to offset premium tax liability by the same percentage as the percentage payment due on each estimated payment date.
- Claim the tax offsets by attaching a copy of the PTP certificate to the estimated or annual insurance premium tax return to which the offset was to be applied.

The tax offsets that a purchaser used with respect to any year could not exceed the full liability of the purchaser for premium taxes for that year.

Department Responsibilities

The Department of Treasury would be required to administer the program authorized by the proposed Act and would have the powers and duties necessary or proper to carry out the Act, including the following:

- Authorizing the issuance of PTP certificates to purchasers to evidence the right to offset the tax liability under Part 2 of the Income Tax Act or Section 476a of the Insurance Code.
- Arranging for the issuance of the PTP certificates and the tax offsets in an amount not to exceed 10% of the amount stated in each certificate per premium tax year for 10 consecutive premium tax years, beginning with the year associated with the first annual premium tax return date following the fund allocation date.
- Soliciting proposals and selecting a manager; contracting for other services it considered necessary or useful for the sale of PTP certificates; and paying the manager costs incurred from the proceeds of the sale of the certificates.

The Department also would have the power and duty to review and approve or disapprove the proposals from prospective purchasers negotiated and presented by the manager; agree or disagree with the manager's recommendation to sell PTP certificates to the purchasers in a public or private sale; approve or disapprove the negotiated price to be paid by the purchasers for the certificates; determine the form and denomination of the certificates; and determine other administrative details regarding the certificates as the Department deemed useful.

The Department could promulgate rules to implement the program.

Manager

Within 30 days after the effective date of the proposed Act, the Department would have to issue a request for proposals and select a

person to be the manager for all purposes under the Act. The request for proposals would have to include a statement of the services sought, the time and date for the receipt of the proposals and of the public opening, and all of the terms and conditions applicable to the designation of the manager, including the requirement that the manager satisfy all of the criteria described below.

The applicant, or a subcontractor of the applicant, would have to have experience in structuring, marketing, and preselling insurance premium tax credit obligations and have previously marketed and secured purchase commitment agreements in an amount not less than \$400.0 million of premium tax credit or offset certificates in at least five states. If a subcontractor were used to meet these requirements, the subcontractor would have to have been authorized to do business in Michigan on or before January 1, 2012.

The applicant would have to have experience during the previous calendar year with underwriting and marketing state and local securities.

The applicant would have to have over \$5.0 billion in equity capital.

The applicant would have to have experience during the previous calendar year in managing a minimum of 50 financing transactions nationwide each in excess of \$50.0 million.

Report

Within 30 days of the fund allocation date, the manager would have to report the following to the Department:

- The name of each purchaser from which prepayment of insurance premium taxes was received, including the purchaser's tax identification number.
- The amount of each purchaser's prepayment and the amount stated in each PTP certificate delivered to the purchaser.
- The fund allocation date that applied to that prepayment.

PTP Certificate Assignment

A purchaser of a PTP certificate could assign the certificate and the tax offsets associated with it to another insurance company in this State with a liability for premium taxes. Within 30 days of the assignment, the assignor would have to give the Department a written notice of the assignment, indicating the name of the assignee, the amount of tax offsets being assigned, and the year or years to which the offsets were allocable. The assignee could not use the assigned tax offsets until after this notice was filed with the Department. The assignee then would be deemed a purchaser.

Other Provisions

A purchaser would not be required to reduce the amount of tax liability the purchaser included in connection with the ratemaking for any insurance contract written, because of a reduction in the purchaser's assessment derived from the tax offsets granted under the proposed Act.

If the premium taxes that a purchaser did not pay because of the tax offsets would increase any other tax or constitute a credit against any other tax or assessment if paid, the purchaser would continue to earn that reduction in taxes or credit as though the insurance premium taxes were paid by cash.

A purchaser claiming a tax offset against premium taxes would not be required to pay any additional insurance retaliatory tax levied by the State as a result of claiming the tax offset.

For statutory accounting purposes, a purchaser could treat the assignable tax offsets or tax credits as an admitted asset in accordance with the National Association of Insurance Commissioners accounting practices and procedures manual, and pursuant to the statement of statutory accounting principle no. 94 or any substitute statement of accounting principle that replaced principal no. 94.

If the premium taxes imposed by this State were eliminated or reduced, a PTP certificate could be used to offset any other replacement tax imposed on a purchaser that had premium tax liability on the date of the elimination or reduction.

Intent

The bill states, "This act is intended to create a source of funds for appropriation by the legislature."

Senate Bill 986

Part 2 of the Income Tax Act imposes a tax on insurance companies equal to 1.25% of gross direct premiums written on property or risk located or residing in Michigan. The tax applies to insurers authorized to transact insurance in the State. An insurance company is subject to the tax imposed by Chapter 2 or by Section 476a of the Insurance Code, whichever is greater.

The bill would add Section 645 to permit the holder of a PTP certificate to claim a credit against the tax imposed by Part 2 or Section 476a equal to 10% of the amount stated in the purchase price of the certificate. For tax years beginning after December 31, 2013, and each subsequent tax year through the 2023 tax year, an insurance company that purchased a PTP certificate would earn a vested right to a tax credit under Section 645.

The amount of the credit that could be claimed could not exceed the taxpayer's tax liability for the tax year. If the amount of the credit allowed and any unused carryforward of the credit exceeded that taxpayer's tax liability for the tax year, the excess portion could be carried forward to offset tax liability in subsequent tax years for 10 years or until used up, whichever occurred first.

A taxpayer could not claim a credit under Section 645 unless the Department of Treasury or its designee had issued a PTP certificate to the taxpayer. The taxpayer would have to attach a copy of the certificate, as well as a signed and notarized statement attesting to its authenticity, to the annual return on which a credit was claimed.

A taxpayer could claim a portion of a credit and assign the remaining credit amount. A credit amount assigned could be claimed against the assignee's tax liability under Part 2 on the Income Tax Act or Section 476a of the Insurance Code. An assignment would have to be made on a form prescribed by the Department. Within 30 days of the

assignment, the assignor and assignee would have to send a copy of the completed assignment form to the Department in the tax year in which the assignment was made, and attach a copy to the annual return filed for that tax year.

The bill also provides that the total amount of PTP certificates that the Department could issue could not result in more than \$900.0 million in credits.

Senate Bill 987

Section 476a of the Insurance Code imposes what is called a retaliatory tax on foreign insurers doing business in Michigan. When an insurer's state of incorporation imposes a larger aggregate tax burden on a Michigan insurer doing business in that state than Michigan imposes on a company from that state doing business in Michigan, the foreign insurer must pay the amount that its state of incorporation would require a Michigan insurer to pay.

For tax years beginning after December 31, 2013, and for each subsequent tax year through the 2023 tax year, the bill would allow an insurer to credit against the retaliatory tax an amount equal to the amount of the credit the insurer would be eligible to claim for a PTP certificate during the respective tax year under Section 645 of the Income Tax Act, if the insurer were paying the tax imposed under Part 2 of that Act.

The bill specifies that this credit would not be related to the business of insurance or the calculation of any special burden, and could not be construed as authorizing the application of any other credit against the tax imposed by Section 476a of the Code.

Section 476a states that its purpose is to promote the interstate business of domestic insurers by deterring other states from enacting discriminatory or excessive taxes. The bill would add that, to achieve this purpose and to avoid weakening the intended deterrent effects, credits against the tax under the Code would not be permitted except as provided in the bill.

Proposed MCL 206.645 (S.B. 986)
MCL 500.476a (S.B. 987)

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The Department of Treasury would experience increased costs of an unknown amount in order to issue and evaluate a request for proposals for a manager of the program, ensure that the manager and its subcontractors had the minimum experience and equity required by Senate Bill 985, and pay fees to the manager and other contractors if necessary to operate a program to sell PTP certificates.

The bills would increase General Fund revenue in the first year the bills were effective and reduce General Fund revenue in future years. The magnitude of the changes would depend upon a variety of factors, but assuming that the full \$900.0 million of prepaid tax credits were approved, the legislation would reduce General Fund revenue by approximately \$90.0 million per year for tax years from 2014 through 2023. The increase in General Fund revenue would depend on the discount rates used to price the prepaid credits and the fees charged to arrange the sales, but estimates and assumptions by a firm that offers such services suggest the revenue could total \$774.1 million.

The reduction in revenue in future years could be less than \$90.0 million if a taxpayer's credit amount exceeded its liability and the taxpayer were unable to transfer any remaining credit amount to another taxpayer or to carry the amount over to a future fiscal year. Similarly, Senate Bill 987 would potentially eliminate any other credits that a taxpayer could claim under the Insurance Code, such as the credit provided under MCL 500.440a for workers' compensation payments.

On the other hand, the revenue loss could exceed \$90.0 million in a given year. While proposed Section 645(1) in Senate Bill 986 would limit the amount of a credit to 10% of the purchase price of the certificate, subsection (2) indicates that a taxpayer could combine a credit with an unused carryforward from a prior year. In such an event, it is unknown whether the limit on credits equaling 10% of the purchase price would control, or whether the limit could be exceeded due to carryforward amounts. Subsection (1) also would appear to eliminate any carryforward from reducing revenue in tax years after 2023.

While the certificates would not constitute a debt for the State, the reduction in future revenue would have implications for the State's ability to meet other obligations and thus could have a secondary impact on the State's creditworthiness. The fiscal implications of allowing insurance companies to count the prepaid portion of future tax liabilities as admitted assets are unknown. Admitted assets are considered liquid assets, used by a company to demonstrate to State insurance regulators the extent to which its capital reserves are adequate. The transferable nature of the certificates would make them relatively liquid.

The extent to which the bills could require the State to allow taxpayers to use the certificates to offset "any other replacement tax" if current insurance company taxes were eliminated or reduced, would depend upon what legislative changes occur in the future. Such sections, once adopted, as well as any other section of the proposed legislation, could be amended or deleted by any future legislature.

In addition, several qualifications imposed by the bills are not defined. While the bills would allow for time-discounted pricing for certificates, the bills do not specify a discount rate or place ranges on the allowable discount rates the Department or manager could use in pricing certificates. Similarly, the bills do not place limits on the compensation or fees that a manager could charge to administer the program. Entities applying to become the manager would have to meet several criteria, although in some cases those criteria are not defined. For example, Senate Bill 985 would require that applicants have experience in managing a minimum of 50 financing transactions nationwide, each in excess of \$50.0 million, but does not indicate what sorts of financing transactions would be relevant to the qualification.

Fiscal Analyst: Elizabeth Pratt
David Zin

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.