

# Tax-Exempt Organization Insurance Premium Tax Deduction



OFFICE OF THE STATE AUDITOR

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Colorado generally imposes a 2 percent premium tax on insurance companies' premiums written in the state. **The Tax-Exempt Organization Insurance Premium Tax Deduction (Tax-Exempt Organization Deduction) allows insurers to deduct any premiums collected for policies purchased by tax-exempt organizations from their taxable premiums.** This deduction was originally enacted in 1969, and is likely intended to reduce the costs of tax-exempt organizations' insurance policies for their employees by allowing insurers to reduce premium costs on policies that they do not pay premium tax on.

**Although some insurers are aware of and claiming the deduction, we could not determine the number of insurers claiming it or the amount claimed, and it is possible some eligible insurers might not be claiming it. Additionally, we could not determine the extent to which the deduction results in reduced premium costs for tax-exempt organizations.**

- According to Division of Insurance (Division) data, between Tax Years 2018 and 2022, at least 20 insurance companies claimed the deduction. However, because the Division's premium tax filing forms do not include instructions or guidance on the types of premiums that qualify for the deduction or where to claim them, we could not determine if all of the insurers who claimed the deduction were eligible, or if there were insurers who could have been eligible for the deduction but did not claim it.
- Insurers who claimed the deduction reported that any cost savings that they incur is factored into the premium amounts for policies sold to tax-exempt organizations. However, there are many factors that go into insurance policy pricing, and insurers could not provide data on the actual cost savings they may have passed on to the tax-exempt organizations.

## Policy Consideration

The Division could consider providing written instructions for insurers on its tax filing forms, along with guidance on the types of premiums that are tax exempt and how they should be claimed. We included the same policy consideration in our previous evaluation of this expenditure in 2019.

Tax Type:	<b>Insurance Premium Tax</b>	Year Enacted:	<b>1969</b>
Expenditure Type:	<b>Deduction</b>	Repeal/Expiration Date:	<b>None</b>
Statutory Citation:	<b>10-3-209(1)(d)(IV), C.R.S.</b>	Revenue Impact:	<b>Estimated between \$4 million to \$10 million</b>

Purpose given in statute or enacting legislation? **No**



# Tax-Exempt Organization Insurance Premium Tax Deduction

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## Background

Colorado generally imposes a 2 percent premium tax on insurance companies' taxable premiums written in the state. **The Tax-Exempt Organization Insurance Premium Tax Deduction (Tax-Exempt Organization Deduction) allows insurers to deduct premiums collected for policies purchased by tax-exempt organizations for their employees from their taxable premiums.**

In order for the premiums to qualify for the deduction, the employer purchasing the policy or contract must be the State, a political subdivision of the State, or exempt from state income tax under Section 39-22-112, C.R.S., which includes charitable organizations, religious organizations, private foundations, and other non-profits. Only insurance products that are subject to premium tax qualify for this deduction. Therefore, some insurance coverage purchased by tax-exempt organizations, such as self-insurance, premiums purchased through non-profit insurers, or premiums purchased through Health Maintenance Organizations, would not qualify under this deduction.

This deduction was originally enacted in 1969, at a time when the General Assembly was passing other bills related to expanding access to insurance benefits. At the time, no purpose was included in the legislation; therefore, it is unclear whether the deduction was originally intended to increase access to insurance by reducing premium costs for tax-exempt organizations, or as a way to apply the same type of tax treatment to organizations that are not normally taxed (i.e., similar to the sales tax exemption for charitable organizations).

While the original purpose is unclear, based on its current operation and feedback from stakeholders, **the deduction is likely intended to reduce the costs of tax-exempt organizations' insurance policies for their employees by allowing insurers to reduce premium costs on policies for which they do not pay premium tax.**

Insurers directly claim the tax deduction on any eligible premiums they write. Tax-exempt organizations do not directly benefit from the deduction; however, if the insurer pays less in

### Technical Note

Employers who self-insure pay some or all of employees' claims from their own funds, although they often still contract with an insurer to act as a "third-party administrator." Self-insurance is not classified as an insurance product in Colorado and is not subject to premium tax.

Many larger public sector employers, such as the State and local governments, self-insure for various types of employee insurance coverage.

premium taxes, they could pass that cost savings onto the tax-exempt organizations by reducing the cost of their premiums.

We developed the following performance measures to evaluate the deduction:

- The extent to which insurers are aware of and applying the deduction.
- The extent to which the deduction reduces the cost of insurance that the State, political subdivisions of the State, and other tax-exempt organizations purchase for their employees.

## Evaluation Results

**Although some insurers are aware of and claiming the Tax-Exempt Organization Deduction, we could not determine the number of insurers claiming it or the amount claimed, and it is possible some eligible insurers might not be claiming it.** Overall, according to Division of Insurance (Division) data, between Tax Years 2018 and 2022, at least 20 insurance companies claimed the deduction. Of these, 19 insurers made up about 30 percent of the total life, health, and accident premiums sold in Colorado between 2018 and 2022, and one insurer made up about 5 percent of total property and casualty premiums during the same time period. However, there could have been more insurers that were eligible for the deduction but were not aware of it because the Division's tax filing forms do not provide guidance on the types of premiums that qualify for the deduction. Additionally, the Division's tax forms have several allowable deductions listed, but there are no instructions for insurers on what premiums to include under each deduction. Specifically, the Division has a deduction labelled "Political Subdivisions" and one labelled "Other Deductions" with no additional instructions on what premiums qualify for each deduction. Division staff reported that they were unsure where insurers should claim their qualified premiums, but thought they might be claimed under Other Deductions. We reviewed Division data for Tax Years 2018 through 2022 and found that insurers were inconsistent in how they reported their qualified premiums. For example, 15 of the insurers reported their premiums under the Political Subdivisions column of the form, three insurers claimed non-profit premiums under the Political Subdivisions column and the Other Deductions column, and another insurer claimed their state and municipal agency premiums under Other Deductions. Additionally, several other insurers did not separate out their premiums that are not taxable due to other deductions—such as premiums for Medicare, Federal Employee Health Benefits, or tax-exempt annuities—or did not specify which deduction they were using. Because of these inconsistencies in reporting, we could not determine the total value of premiums sold to tax-exempt organizations, the breakdown of premiums written for political subdivisions versus non-profits, or the type of insurance that was sold. Additionally, in 2022, the Division modified its form to include instructions for insurers on where to report premiums for taxable and nontaxable annuities, which are not specific to tax-exempt organizations, but the form had an error that instructs insurers to claim their non-taxable annuities under the Political Subdivisions line. We identified at least one insurer that listed its taxable annuity premiums

under the Political Subdivisions deduction, and may have erroneously deducted premiums that should have been taxed. The Division has since removed this error from the forms.

Based on the 20 insurers that explicitly claimed the Political Subdivisions deduction and/or only listed “non-profit” or “state and municipal agency” and did not list the premiums as “annuities,” we calculated an average minimum revenue impact to the State for the deduction of about \$4 million annually during 2018 to 2022, representing an average of \$204 million annually in premiums written to tax-exempt organizations. When including premiums for tax-exempt organizations that were aggregated with other tax-exempt premiums—and premiums where the insurer did not specify the “Other” deduction they were using—the maximum revenue impact was an average of about \$10 million annually during 2018 to 2022, representing an average of \$504 million in premiums written.

While it appears that insurers are aware of and applying this deduction, we could not determine whether there are insurers who write eligible premiums but are not aware of and, as a result, have not used the deduction. We contacted all 20 insurers who claimed the deduction, as well as a life insurance advocacy member organization, to determine whether insurers are consistently using the deduction. One insurer, representing about 19 percent of the premiums deducted, responded that they consistently use the deduction and did not have any trouble claiming it. Additionally, the advocacy organization responded that the industry is aware of the deduction, so most insurers are probably claiming it; however, the organization stated that their members are not consistent about where they claim it on the tax filing form. We also contacted three non-profit organizations that purchase eligible coverage for their employees, and determined that their insurers claimed the deduction. However, because the Division’s tax filing forms do not include any guidance on the deduction or explanation of the premiums that qualify for the deduction, it is possible there are some insurers that write premiums for tax-exempt organizations that are not claiming the deduction.

We researched policies in other states and only two states, Kentucky and New York, have a deduction similar to Colorado’s, so it is not necessarily a common practice that insurers would be aware of. There are 12 other states and the District of Columbia that have a similar, but more narrow tax deduction, such as limiting the tax deduction to premiums covering public employees; many do not have a tax deduction for premiums sold to non-profit or other tax-exempt organizations.

**We could not determine the extent to which the deduction results in reduced premium costs for tax-exempt organizations.** Price setting for premiums involves actuarial analyses, and generally, insurers will set benchmark rates for policies based on groupings of clients that share similar risks. Because tax-exempt organizations may or may not share similar risks as private companies, we contacted the 20 insurers who claimed the deduction and a life insurance advocacy member organization to determine the extent to which the premium tax deduction influences insurers’ premium pricing. We received responses from four insurers and the advocacy organization, all of which reported that the deduction helps the insurer lower the price of premiums sold to tax-exempt organizations. One stakeholder reported that if the tax-exempt organization makes the

insurer aware of the deduction during the RFP, the insurance company will factor the cost-savings into the organization's premium pricing. However, none of the insurers were able to provide us a cost comparison of a policy that is subject to premium tax versus one that is not, or an overall cost savings provided to tax-exempt organizations as a result of the deduction. Therefore, we could not determine the extent to which the 2 percent premium tax savings is passed on in the form of a reduction in premium pricing for tax-exempt organizations.

## Policy Consideration

**Due to inconsistencies in taxpayer reporting of the Tax-Exempt Organization Deduction, the Division could consider providing written instructions for insurers on its tax filing forms and guidance on the types of premiums that are tax-exempt and how they should be claimed.** We included the same policy consideration in our 2019 evaluation of the deduction. In 2019, the Division reported that it was developing updated instructions for its tax filing forms and provided draft guidance that it had prepared; however, as of 2024 the forms had not been updated and the guidance had not been issued. In 2024, Division staff reported that they anticipate that the replacement of their legacy filing system will allow for clearer filing data fields for insurers. Updating the tax filing forms and issuing the guidance would help ensure that any insurers that are eligible for the deduction are aware of it, and are therefore, more likely to claim it. This would also help ensure that insurers claim the appropriate premiums as a deduction, so the General Assembly and the Division have accurate data on the use and revenue impact of this expenditure.

## OFFICE OF THE STATE AUDITOR

State Auditor	<b>Kerri L. Hunter, CPA, CFE</b>
Deputy State Auditor	<b>Michelle Colin, JD</b>
Evaluation Managers	<b>Trey Standley, JD</b> <b>James Taurman, MPA</b>
Evaluation Supervisor	<b>Meghan Westmoreland, MBA</b>



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