Debbie Bartuccio

From:	Reed Holwegner
Sent:	Wednesday, December 09, 2015 9:20 AM
To:	Debbie Bartuccio; ddbartuccio@yahoo.com
Cc:	Chris Courtwright; Gordon Self; 'Scott W. Smith'; Adam Siebers
Subject:	FW: aia tax letter
Attachments:	Brad's Testimony 12-7-15 re Premium Tax Employee Salary Credit..doc

Debbie,

Please incorporate this email and attachment into the minutes for the Dec 9 meeting.

Reed

From: Debbie Luper
Sent: Wednesday, December 09, 2015 9:01 AM
To: Ty Masterson; Steve Abrams; Tom Holland; Julia Lynn; Jeff Melcher; Greg Smith; marviin.kleeb@house.ks.gov; Ken Corbet; Mark Hutton; Jerry Lunn; Marc Rhoades; Tom Sawyer; Kathy Wolfe Moore
Cc: Edward Penner; Reed Holwegner
Subject: FW: aia tax letter

Good morning!

Chairman Masterson asked me to forward the following email and testimony for your information and review.

Best regards,

Debbie Luper, Chief of Staff
Senator Ty Masterson, Chairman
Senate Ways and Means Committee
Room 545-S
debbie.luper@senate.ks.gov
785.296.5415

Begin forwarded message:

> **From:** Brad Smoot <bradsmoot@smootlawoffice.com>
> **Date:** December 8, 2015 at 4:57:34 PM CST
> **Subject: Fwd: aia tax letter**
>
> Mr. Chairman - After the last meeting of the Special Committee on Taxation, I promised to provide you with a short history on the insurance premium tax salary credit. My concern is that the committee may not have a very complete understanding of how the salary credit came about, why it was necessary, how insurance companies operate with their "affiliates" and just how beneficial the credit has been for Kansas jobs.
>
> Attached is a Memorandum reciting a bit of history that I hope will be helpful to you. Please feel free to share it with your colleagues as you see fit.

Special Committee on Taxation
Date: 12-9-15
Attachment: 5

I wish I could be in attendance at tomorrow's committee meeting but am obligated to be elsewhere on business for the next few days. Larrie Ann plans to cover the meeting so please feel free to contact her if you have questions. She is well versed on the issue.

Please do not hesitate to contact me at your convenience. - Brad

Subject: aia tax letter

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Memorandum

To: The Honorable Ty Masterson
Chair Special Committee Taxation
From: Brad Smoot, American Insurance Association
Date: December 7, 2015
Subject: Premium Tax Employee Salary Credit

Per our conversation, allow me to provide some background regarding the premium tax employee salary credit. As you know from the excellent presentations of staff and the Insurance Department at your first meeting, the current law authorizing the employee tax credit against the 2% premium tax is contained at K.S.A. 2013 Supp. 40-252d. It provides a credit for only 15% of the salaries paid to Kansas employees not to exceed 1.125% of a company's premium tax obligation or 1% if the company counts its affiliates.

The change in Kansas premium tax was made necessary by the obvious unconstitutionality of State's prior tax structure that imposed a 2% tax on foreign carriers doing business in the state and a 1% tax on domestic insurers. In 1985, the U.S. Supreme Court declared in Metropolitan Life Insurance Co. v. Ward, that such disparate tax treatment was a violation of the Equal Protection Clause and thereby unconstitutional. Unlike many states that had similar questionable tax structures, Kansas did not promptly modify its tax rates accordingly. Ultimately, Kansas became the last state to correct the illegal tax on foreign insurers but not until the state had piled up $100 million in taxes paid under protest which would need to be refunded.

In 1997, the Insurance Department brought the matter to the attention of the Legislature and offered a proposal to equalize the rate to solve the constitutional problem but which would have substantially raised taxes on domestic insurers while reducing it on foreign carriers. Some in the legislature did not care for this proposal and others sought to reduce the tax for all to 1% as many states have done. My recollection is that the Senate was more inclined to the tax increase on domestics to 2% and the House version would have reduced the tax for all insurers to 1%. Ultimately, the Legislature agreed to a 2% premium tax with the salary credit as a way of encouraging insurers to maintain, move or expand operations in Kansas while equalizing the tax rate for all. Most importantly, many of the insurers who had filed taxes under protest (and were prepared to claim a refund of the excess tax) agreed to waive their multi-million dollar claims if the bill was enacted.

Upon passage of the salary credit, foreign insurers paid the same tax unless they had employees in Kansas; insurers licensed in Kansas did not see a tax increase but only if they had substantial employee salaries in Kansas and the state of Kansas continued to see stable and growing stream of premium tax revenues.

In 2001, the Kansas Legislature reviewed and modified the original 1997 tax bill, slightly changing the tax credit formula and modestly increasing premium tax revenues. The changes did not alter the corrections made to meet the constitutional requirements or undermine the "deal" made in 1997 with the foreign insurers who had paid (and then waived) millions in taxes under protest. That same year, an independent consultant (Ernst & Young), analyzed the favorable economic impact of the Premium Tax Employee Credit. And the CEO of Universal Underwriters wrote to Governor Graves in that same month confirming his company's domestication to Kansas with his 1000 employees and the of Farmers Insurance Group confirmed its intention to bring 500 jobs to the state the following year. I believe that Farmers has now added nearly 3000 jobs at their KC area call center.

My principal concern is some confusion raised during the committee hearing about the affiliate language. To begin with, insurance companies operate differently than many other industries. Multiple companies (with different names and licensing jurisdictions) are owned and operated by the same parent company, utilizing the same employees and officers to manage the various affiliates. Whether the affiliated company is licensed in Kansas or some other state is of little significance if the employees serving the affiliated companies are located in Kansas, Kansas gets the benefit. In addition, the credit only applies against premium on policies sold in Kansas. The whole notion of "out of state" companies is meaningless in this context.

The affiliate language was carefully crafted to encourage commonly-owned insurance groups, wherever an affiliate might be licensed, to add or maintain employees in Kansas. Please remember that the whole impetus for the 1997 change was to eliminate the discrimination against insurers doing business in Kansas but licensed elsewhere. The employee salary credit accomplishes the goal of equalizing premium taxes among companies no matter where they are licensed while promoting economic development and employee retainage in Kansas. I would hate for some members of the committee to think that the employee salary credits are given to insurance companies with no connection (employees) in Kansas. This is not some mechanism where tax credits can be sold (like carbon credits) to an unrelated company with no connection to Kansas. The premium tax comes from Kansans and the employee salaries claimed as the credit must be based in Kansas and can only be claimed by a family of affiliated companies who use those employees to serve the affiliated companies and their customers.

Lastly, there was some suggestion that other states don't provide similar economic incentives with their premium tax. Our research suggests that about 17 states have some tax incentive programs to attract insurance jobs to their states. The surrounding states of Colorado, Oklahoma and Iowa have similar job related tax incentives for bringing headquarters and regional offices to their jurisdictions. Florida has a salary credit very similar to Kansas. Many other states have taken the option of equalizing premium taxes at 1%, something Kansas could have done in 1997, as a way to encourage insurers to move to their states. There is a lot of competition among the states for clean, well-paying insurance jobs. As the huge expansion of Farmers Insurance employment in Kansas clearly demonstrates, insurance jobs can go almost anywhere. I would imagine we are pretty happy to have those jobs here.

Please let me know if we can be of further assistance on this topic.

Brad