



A Brief Analysis of
Insurance Industry Share of
State of Michigan Business
Tax

Gary Wolfram, Ph.D.
November 14, 2006



A Brief Analysis of Insurance Industry Share of State of Michigan Business Tax

Gary Wolfram, Ph.D.
November 14, 2006

There has been a good deal of confusion about the share of Michigan's business tax that is paid by the insurance industry. While Michigan insurance companies pay in Single Business Tax (SBT) more than four times their share of Gross State Product (GSP), many believe that they pay less than half of their share of GSP.

Much of this confusion has been caused by unclear presentation of data in the Single Business Tax Report of Michigan's Department of Treasury.¹ The result is that a cursory reading of the exhibits in the report presents a view of the importance of insurance company taxes much different than what is the actual case. Presentations by the House and Senate Fiscal Agencies have used the category of "finance, insurance, and real estate," from the SBT Report in showing the percentage of SBT liability paid by industry, and many have assumed that this category includes the insurance industry. A careful reading of the report makes it clear that insurance company taxes are **not included** in this category. (See the parenthetical phrase on page 7 of the report.) With respect to insurance, this category includes only the tax liability of insurance agents. To make matters more confusing, insurance company taxes are included in the first two exhibits of the Treasury SBT Report, those dealing with total SBT revenue history, and then are **excluded from the rest of the report**.

These same presentations by the fiscal agencies then include insurance companies in the share of Private Gross State Product produced by the industry category "finance, insurance, real estate" when comparing share of SBT liability to share of Gross State Product. It thus appears from the presentations that the insurance companies **are** included in the SBT revenue by industry category, and thus have a significantly smaller share of business tax liability than their share of business activity. Actually, just the opposite is the case.

I. Insurance Industry's Share of the Tax: Empirical Analysis

The available data on states that most closely resembles state value added (which is essentially the tax base of the SBT) is Gross State Product, as calculated by the Bureau of

¹ Michigan Department of Treasury, *The Michigan Single Business Tax: 2000-2001*, February 2006.

Economic Analysis of the U.S. Government. It is for this reason that Senate Fiscal Agency and House Fiscal Agency use industry share of Private Gross State Product in their comparisons. While the most recent available data on GSP are for the year 2005, the most recent SBT liability for industry class is for 2001. In that year, total Gross State Product for Michigan was \$334.419 billion. The Gross State Product of the insurance industry was \$6.457 billion. Thus, insurance companies comprised 1.9% of Gross State Product. If we subtract government production, Private Gross State Product was \$299.665. The insurance industry's share of this was 2.15%.²

Total SBT collections, including all taxes on insurance companies, were \$2.33 billion in tax year 2001.³ The insurance tax collections were \$226.52 million. Thus, insurance companies paid 9.72% of the state's business tax, more than four and one-half times the industry share of Private Gross Domestic State Product, and more than five times its share of Gross State Product.

II. History of SBT and Retaliatory Taxes Paid by Insurance Companies

All insurance companies pay the either the SBT or a retaliatory tax. Michigan-based companies pay the SBT. Foreign (out-of-state) insurance companies calculate their SBT liability and compare that to what a similarly placed Michigan company would pay in their home state. If the home-state tax for a similarly placed Michigan company would be greater than the foreign company's SBT, then the foreign company pays, in place of its SBT liability, a retaliatory tax equal to the amount the Michigan company would pay in the foreign company's state.

Under the SBT statute, MCL 208.22f, then, foreign companies actually pay either the SBT or the retaliatory tax, whichever is greater. For Table 1 below, Treasury has kindly separated the tax of foreign companies into the SBT portion for those actually paying the SBT and, for those paying a retaliatory tax, both the calculated ("hypothetical") SBT portion of the tax and how much the retaliatory tax adds to their liability (add-on).⁴

² Data are available at <http://bea.gov/bea/regional/gsp>.

³ This is calculated by adding Treasury data from Table 1 of this report and the Single Business Tax liability from Exhibit 3 of *The Michigan Single Business Tax: 2000-2001*, which excludes insurance company taxes.

⁴ The table uses information provided through personal correspondence with the Office of Revenue and Tax Analysis.

Table 1

INSURANCE TAX SUMMARY, TAX YEARS 2001 - 2005

amounts in millions of dollars

<u>Insurance Co. Domicile</u>	<u>Tax</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Michigan	SBT	54.40	62.88	52.74	56.02	71.49
Other	SBT+Retaliatory	172.12	183.50	173.76	179.16	182.09
Total Insurance Tax		226.52	246.38	226.30	235.18	253.58
Tax By Status						
Michigan	SBT	54.40	62.88	52.74	56.02	71.49
Other--do not owe MI Retaliatory Tax	SBT	51.28	45.42	43.92	35.10	49.35
Other--owe MI Retaliatory Tax	SBT (Hypothetical)	73.47	74.26	70.12	79.43	79.91
Other--owe MI Retaliatory Tax	Retaliatory (add-on)	<u>47.37</u>	<u>63.82</u>	<u>59.52</u>	<u>64.63</u>	<u>52.83</u>
Total Insurance Tax		226.52	246.38	226.30	235.18	253.58

As can be seen from the table, Michigan-based insurance companies in the last five years have paid a low of \$52.74 million and a high, in 2005, of \$71.4 million. Out-of-state based insurers paid a low of \$172.12 million in 2001 and a high of \$183.50 million in 2002. (They nearly matched this in 2005 with a tax of \$182.09) Of this amount the highest retaliatory add-on to the SBT liability was \$64.63 million in 2004 and the lowest was \$47.37 million in 2001. The lowest total tax paid by insurance companies in Michigan was \$226.30 in 2003. The highest was \$253.58 million in 2005.

III. Insurance Industry's Share of the Tax: Statutory Analysis

If we look at the statute it is clear that the insurance industry must pay a higher tax on its value-added than other industries. This is because the tax base of insurance companies, while it appears as a percentage of adjusted receipts, is in fact the industry's value added. The theoretical basis for determining the value added of an insurance company was grounded in a 1987 *National Tax Journal* article, and uses the subtractive method of determining the base rather than the additive method.⁵ The base, as found in Section 22a, is .25 times the adjusted receipts of an insurance company. This is a simplified calculation that approximates the value added of insurance companies, which is

⁵ V. Barham, et alia, "The Tax Treatment of Insurance Under a Consumption Type, Destination Basis VAT," *National Tax Journal*, Vo. XL, No. 2, June 1987, pp. 171-182.

essentially their premiums minus the cost of payouts.⁶ To this base is applied the rate of the SBT that is common to all companies.

Section 22b of the Act applies a surcharge solely on insurance companies that is 1.26 times their calculated tax liability. This means that the industry pays a tax on its value added that more than doubles the tax relative to other industries. There is a credit that can be applied to this surcharge in Section 22c, however, these credits are for payments into five guaranty associations and placement facilities, which are in effect other taxes on insurance companies. These are the Michigan workers compensation placement facility, the Michigan basic property insurance association, the Michigan automobile reinsurance placement facility, the property and casualty guaranty association, and the Michigan life and health guaranty association.

The total amount of credits under Section 22c is limited to an amount that would leave Michigan-based companies an SBT liability of at least \$30 million annually. Thus, the statutory provisions of the SBT ensure that insurance companies pay a higher share of value added than other industries.

IV. Conclusion

It is clear empirically that Michigan insurance companies pay at least four and one-half times their share of the approximate SBT base in taxes, at least one quarter of a billion dollars per year. A careful reading of the Michigan statute along with an understanding of the value-added of insurance companies makes the reason for this clear. In particular, the added surcharge under Section 22b will ensure a greater tax liability for insurance companies than for other industries.

⁶ For a complete discussion of the issue, see Gary Wolfram, "Taxation of Insurance Companies in Michigan: Court Cass and the Legislative Debate," *Detroit College of Law Review*, Vol. 1988-Issue 1, Spring, pp. 51-63.