

Senator Christopher S. Bond (R-Missouri)
Floor Statement
Clarification of the Tax Exemption for
Small Property and Casualty Insurance Companies
July 28, 2005

Mr. President, I rise today to introduce a bill that addresses an inequity and helps clarify a tax exemption that exists for small property and casualty (P&C) insurance companies under the Internal Revenue Code Sections 501(c)(15) and 831(b). These small P&C insurers, often originally organized as mutual companies to offer insurance coverage to specific groups, mainly serve rural areas and farming communities that otherwise may not have been able to obtain affordable coverage. This tax exemption helps to provide additional surplus and cash flow for these small companies.

The Pension Funding Equity Act of 2004 ("2004 Act") amended the small P&C insurer exemption because there were concerns that certain investment companies offering only a small amount of insurance could use the exemption to improperly shelter investment income from federal income tax. Now, under current law, the exemption applies only to P&C (i.e., non-life) insurance companies if their "gross receipts" for the taxable year do not exceed \$600,000 and if premiums make up more than 50 percent of those gross receipts. A mutual P&C insurance company also may be exempt if its premiums make up more than 35 percent of its gross receipts and its gross receipts do not exceed \$150,000. Additionally, P&C companies that have direct or net written premiums, whichever is greater, exceeding \$350,000 but not exceeding \$1.2 million (Income Election Limit), can elect to be taxed under a similar tax structure on their net investment income.

While the 2004 Act helped to close a potential loophole, the special provisions for small P&C insurers are in need of further clarification or reform. The term "gross receipts" is not defined uniformly for purposes of the Internal Revenue Code and the Income Election Limit has not been adjusted for inflation since the Tax Reform Act of 1986.

Without a clear definition of the term "gross receipts," many unanswered questions remain with respect to determining whether a small P&C insurance company qualifies for exemption under section 501(c)(15). For example, such a company typically invests a large portion of its assets in government bonds. If the gross proceeds on the sale of an asset are included in the measure of "gross receipts," based on a broad cash-flow definition of gross receipts, the mere maturation of bonds and reinvestment could cause a small P&C insurance company to fall out of the exemption even though there has been no change in the size of the business and even if the company realizes a loss on the sale or redemption. On the other hand, this arbitrary result would not occur if a definition of gross receipts that includes gains from the sale or exchange of assets is used. Such a definition of gross receipts looks to the size of the business in terms of income and overall profitability, which in turn ties into the reason for the tax exemption.

If the Income Election Limit is not adjusted to keep pace with inflation, the impact could be severe. Take, for instance, a small P&C insurer in my state that started insuring the local farmers in the late 1980s. Over the ensuing years, the company's client base changed very little, but the insurance premiums increased gradually to keep pace with inflationary pressures. As a result, while the business itself has not grown in absolute terms, its premium base has, therefore resulting in the loss of the elective alternative and simpler tax on investment income.

For the farmers and consumers covered by the small P&C insurer, this loss of the tax exemption or a simpler, more limited tax structure is certain to mean higher insurance premiums, leaving the client with the choice of cutting coverage or paying higher costs, neither of which is a preferred option. This is the last thing our agricultural community needs.

The legislation I am introducing today addresses both of these concerns. This legislation would add definitional language for "gross receipts" clarifying that gross receipts means premiums, plus gross investment income. In addition, the proposal simply increases the Income Election Limit from \$1.2 million to \$1.971 million, and indexes it annually for inflation.

According to the National Association of Mutual Insurance Companies, this legislation will help hundreds of small P&C insurance companies nationwide. Under this proposed legislation, at least 56 of the 82 small insurance companies in my state will be covered, thereby enabling them to continue providing critical insurance coverage to small businesses across Missouri.

With this legislation, we have an opportunity to infuse some fairness into our tax code and at the same time help the thousands of farmers, homeowners, and entrepreneurs covered by small P&C insurers in this country. I ask my colleagues to support this legislation, and I look forward to working with the Finance Committee to see it enacted into law.

Mr. President, I ask unanimous consent to include in the record a copy of the bill following the text of my statement.