

# CROP HAIL INSURANCE PREMIUM TAX EXEMPTION



SEPTEMBER 2018  
2018-TE2

## EVALUATION SUMMARY

THIS EVALUATION IS INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

YEAR ENACTED	1961
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	None
NUMBER OF TAXPAYERS	None
AVERAGE TAXPAYER BENEFIT	None
IS IT MEETING ITS PURPOSE?	No, because it is not being used

### WHAT DOES THIS TAX EXPENDITURE DO?

Insurance companies selling policies in Colorado must pay a premium tax on the amount they collect for insuring in-state property or risks, including crops. Under the Crop Hail Insurance Premium Tax Exemption (Crop Hail Exemption), a portion of the premiums received on crop hail insurance sold by small-scale, member-owned insurers known as “mutual protective associations” is exempt from the premium tax.

### WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state a purpose for this exemption. Based on statutory language, we inferred that its purpose is to improve the ability of farmers to obtain insurance on damage to their crops from hailstorms through mutual protective associations, which would be able to lower farmers’ insurance premiums due to the tax savings.

### WHAT DID THE EVALUATION FIND?

The exemption is not meeting its purpose since no companies are currently eligible to claim it.

### WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may wish to consider either repealing the exemption, since it is not currently being used, or expanding the eligibility requirements for the exemption to increase the companies that may be eligible for it.



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## EVALUATION RESULTS

### WHAT IS THE TAX EXPENDITURE?

In 1883, Colorado began levying a tax on insurance companies' in-state premium revenue, which is the revenue they collect from customers for writing insurance policies covering property or risks in the state. In 1961, Colorado created the Crop Hail Insurance Premium Tax Exemption (Crop Hail Exemption), which exempts certain insurers from paying the premium tax on a portion of the premiums they collect. Specifically, according to Section 10-3-209(1)(d), C.R.S., to be eligible to claim the exemption, an insurer must meet each of the following conditions:

- A Be a “mutual protective association,” which is a small-scale mutual insurance company owned entirely by its policyholders and authorized to sell them insurance policies covering in-state property or damages [Section 10-12-101(1), C.R.S.].
- B Sell only crop hail insurance and not offer any other type of insurance to policyholders.
- C Operate on an “advance premium basis,” meaning that once the insurer sets the premium amount it cannot change during the policy period regardless of actual losses that may occur.

In addition, the exemption only applies to the “portion of the premium designated to the loss fund.” The loss fund is the amount insurers must set aside in a given period in order to cover any payments on claims [Sections 10-12-101(3) and (4), C.R.S.]. Premiums collected and used to pay other expenses of the insurer, such as overhead and salaries, would therefore not be eligible for the exemption.

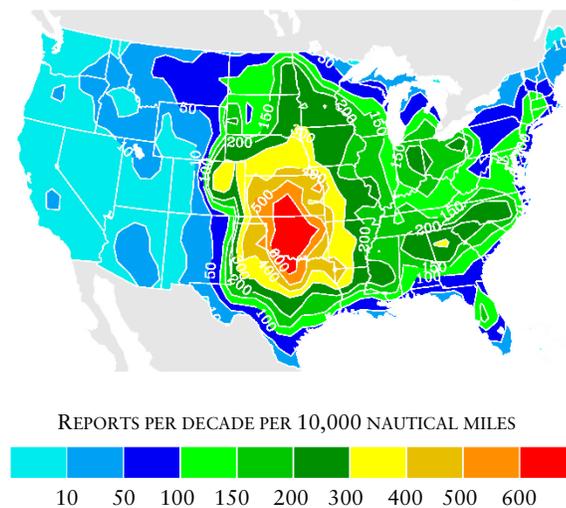
## WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify intended beneficiaries for this exemption. Based on the language in statute and reports prepared by Legislative Council staff at the time the exemption was passed, the beneficiaries were intended to be eligible mutual protective associations and their policyholders, who were farmers in the state that would benefit from crop hail insurance.

According to the National Association of Mutual Insurance Companies, the number of mutual protective associations, which are more commonly known as “farm mutuals,” peaked in 1925 at nearly 2,000 nationwide. As in much of the insurance industry, the following decades saw a large degree of consolidation among mutual insurers, leading to the creation of large companies which offer numerous different insurance products, including crop hail insurance.

In Colorado, crop hail insurance is often important to farmers because a hailstorm can be disastrous for a farmer’s crops and Eastern Colorado lies within a region with frequent hail, known as “Hail Alley” (see EXHIBIT 1.1).

EXHIBIT 1.1. TOTAL HAIL REPORTS, 1955-2002



SOURCE: 2004 National Ocean and Atmospheric Administration report.

## WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for this exemption. We inferred, based on the language of the statute, and the environment surrounding the passage of the exemption, that its purpose was to improve the ability of farmers to obtain insurance on damage to their crops from hailstorms through mutual protective associations, which would be able to lower farmers' insurance premiums due to the tax savings. Specifically, according to a Legislative Council report prepared in 1960, at the time the exemption passed, high private hail insurance rates had historically been a concern in the state and the State's Crop Hail Insurance Program run by the Department of Agriculture was found to not be sufficiently addressing this issue because of low participation among farmers, and a competitive disadvantage with private insurers.

## IS THE TAX EXPENDITURE MEETING ITS PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that the Crop Hail Exemption is not meeting its purpose because no insurers are currently eligible to claim it. Statute does not contain a quantifiable performance measure for the Crop Hail Exemption. Therefore, we created and applied the following performance measure to determine the extent to which the exemption is meeting its inferred purpose:

**PERFORMANCE MEASURE:** *To what extent does the Crop Hail Exemption increase the availability of crop hail insurance to farmers in the state?*

**RESULT:** The Crop Hail Exemption does not increase the availability of crop hail insurance in the state because no taxpayers are currently eligible to use it. Specifically, despite the continuing sale of crop hail insurance in the state, no insurers licensed in Colorado are mutual protective associations that only issue crop hail insurance, as required by the Crop Hail Exemption. Since 1979, there have not been any active

mutual protective associations in the state. Furthermore, all of the State's 351 providers of crop hail insurance offer other types of insurance, such as flood, lightning, livestock, and auto insurance. Insurance stakeholders we contacted reported that there are only a handful of insurers nationwide who solely issue crop hail policies, but none of them are located in Colorado.

#### WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURE?

Since no taxpayers are currently eligible to claim the Crop Hail Exemption, there is no revenue impact to the State and no economic costs or benefits associated with the exemption.

#### WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the Crop Hail Exemption would have no impact on beneficiaries because it is not being used and there are no taxpayers eligible to use it.

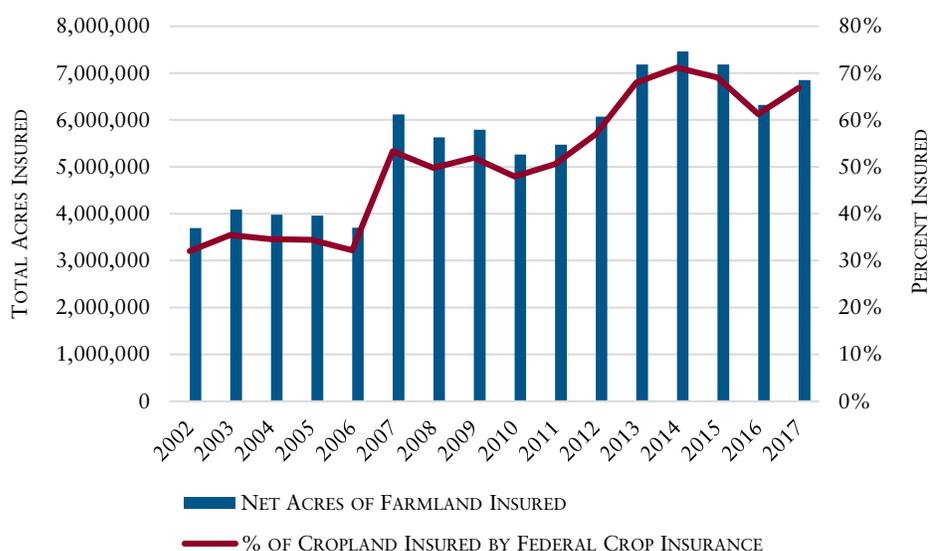
#### ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES OR OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

We did not identify any other states with a tax expenditure for crop hail insurance and there are no other state tax expenditures or programs in Colorado related to stand-alone crop hail insurance issued by a mutual insurance company.

Most cropland in Colorado is now covered by federal crop insurance, which may address the lack of affordable crop hail insurance that led the General Assembly to create the exemption. Federal crop insurance, which grew in popularity in the 1980s and 1990s, is a partnership between the U.S. Department of Agriculture's Risk Management Agency and private insurance companies to offer federally subsidized,

regulated, and guaranteed policies that insure against risks to crops, such as from fire, drought, and disease. These policies often provide limited high deductible hail insurance, though we lacked data to specifically quantify the percentage that include hail insurance. According to the National Crop Insurance Services, in 2017 Colorado farmers paid \$181 million in federal crop insurance and \$14 million in standalone crop hail premium. Colorado does not assess a premium tax on federal crop insurance and states are prohibited from doing so. Farmers are not required to purchase federal crop insurance, but most elect to do so. EXHIBIT 1.2 shows that the percentage of cropland in Colorado covered by federal crop insurance has increased since 2006, with 67 percent of cropland covered in 2017.

**EXHIBIT 1.2. ACRES OF COLORADO CROPLAND COVERED BY FEDERAL CROP INSURANCE, CALENDAR YEARS 2002 -2017**



SOURCE: Office of the State Auditor estimate based on U.S. Department of Agriculture Risk Management Agency and National Agricultural Statistics Service.

## WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURE?

We did not identify any data constraints related to the evaluation of the Crop Hail Exemption.

## WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly could consider either repealing the Crop Hail Exemption or expanding the eligibility requirements for the exemption. Since there are currently no taxpayers who qualify for the exemption and the original purpose of the exemption may be fulfilled by other insurance products, the General Assembly may wish to consider repealing the Crop Hail Exemption. Alternatively, if the General Assembly would like to make the exemption available to more taxpayers to help reduce the cost of crop hail insurance in the state, it could change the eligibility requirements to include a broader range of beneficiaries, so that the exemption could be used to lower the overall cost of crop hail insurance. Despite the availability of crop hail insurance, Colorado farmers continue to pay significantly higher premium rates than farmers in most other states due to the higher risk of hail damage in Colorado compared to other states, which may reduce the number of insured farmers.