



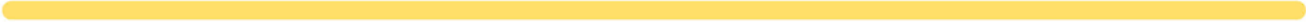
State of Oklahoma

Incentive Evaluation Commission

Home Office Tax Credit

September 29, 2017

PFM Group Consulting LLC
BNY Mellon Center
1735 Market Street
43rd Floor
Philadelphia, PA 19103



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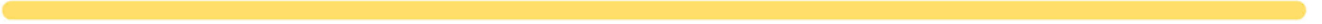
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Executive Summary



Since its creation in 1987, the Home Office Tax Credit has been available to insurance company employers establishing home or regional home offices in Oklahoma that meet certain employment levels. The credit varies based on the number of employees at the home or regional home office and may be used to offset premium tax liability. Although the legislative intent of the incentive is not provided in statute, based on the characteristics of the incentive and its narrow focus on the insurance industry, it is reasonable to infer that the intention of the program is to attract the insurance industry to locate and/or expand in Oklahoma. The fact that the percentage of the credit is based on the number of full-time employees located within the State also suggests that employment is a key outcome of the incentive.

Foregone insurance premium tax revenue associated with the Home Office Tax Credit has grown over the last 10 years (2005-2015) and has outpaced employment gains. While the companies using the credit have shown growth in employment, industry employment overall has declined over the last 10 years. The current structure of the program does not connect increased costs incurred by the State to increased economic benefits (at least as evidenced by levels of employment).

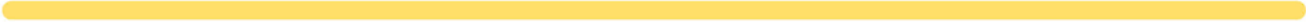
Overall Recommendation: Reconfigure

Key Findings

- **The credit appears to have had little impact on the State's insurance industry employment in recent years.** Insurance industry employment in Oklahoma has declined by 4.2 percent since 2001, while neighboring states, most of which do not have a similar home office incentive, have experienced growth ranging from 6 to 30 percent.
- **Program benefits show little connection to employment growth.** While program costs have increased 43 percent since 2009, the number of employees reported by the qualifying companies has grown by 11 percent. In four of the last six years, the credit amount used has increased, even while net employment at participating companies has declined.
- **The program is a net cost to the State.** Because the credits awarded are not closely related to job growth, it is difficult to connect any significant economic activity to the program. Given this, the fiscal impact of the program is equal to the cost to the State, which has averaged \$18 million annually from 2011 to 2015.

Recommended Changes

- **Recommendation 1: If the intent of the State is to attract insurance industry jobs to Oklahoma, the program should be reconfigured to better relate to job creation.** As currently configured, the State is providing an ongoing incentive for companies that are, in some years, decreasing employment. The State could reverse this course by calculating the credit amount as a percentage of payroll, or by limiting the credit to companies that have created (or at least retained) jobs or payroll over the last year.
- **Recommendation 2: Collect payroll data from companies receiving credits to improve future evaluations.** Future program evaluations would be improved by requiring detailed data regarding payroll of companies qualifying for the credit. Currently, the only requirement when filing for the credit is to report the number of employees at the company. More information regarding wages and job function could provide better evidence of the program's economic impact.



Key Findings and Recommendations



Recommendation: Reconfigure

It appears that the costs associated with the program are not aligned with the benefits that accrue to the State. As program costs grow, both employment and the number of establishments have witnessed declines that do not negatively impact on program eligibility. The project team recommends reconfiguring the program to better align with the fiscal and economic development interests of the State.

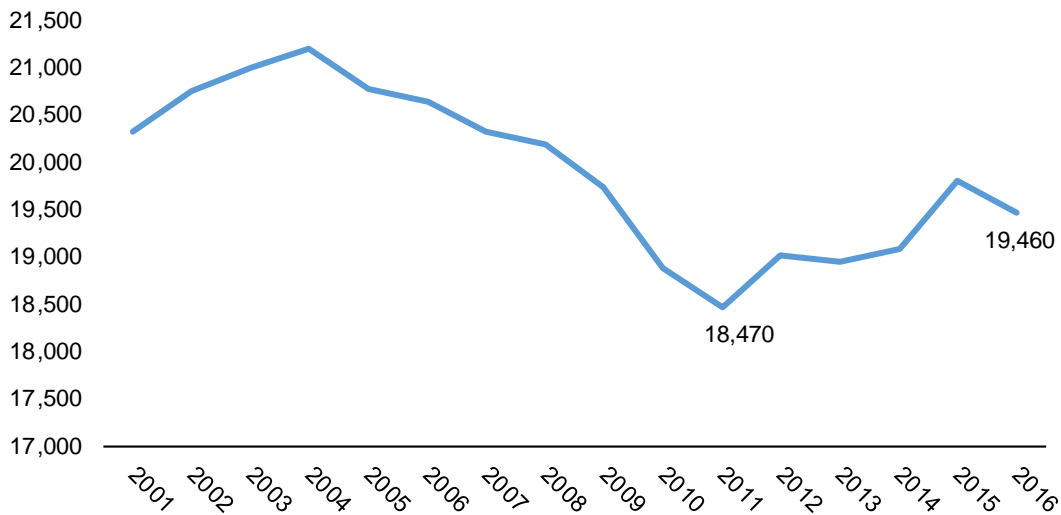
Key Findings

Costs associated with the Home Office Tax Credit have grown significantly over the last 10 years (2005-2015) and have outpaced employment gains. While the companies using the credit have shown growth in employment, the industry overall has declined over the last 10 years. The current structure of the program does not appear to connect costs incurred by the State to economic benefits, particularly as it relates to job creation.

The following analyzes the program's performance in relation to the established criteria for evaluation.

- **The credit appears to have had little impact on the State's insurance industry employment in recent history.** Insurance industry employment overall has declined in Oklahoma over the last 15 years. Employment reached a low point of 18,470 in 2011 before increasing to 19,460 in 2016.

Figure 1: Insurance Industry Employment in Oklahoma, 2001 to 2016



Source: Bureau of Labor Statistics Quarterly Census of Employment and Wages

The following table shows growth in employment in the insurance industry in Oklahoma alongside each of its neighboring states. Oklahoma is the only State in the group that experienced a decline in employment from 2001 to 2016. Neighboring states expanded insurance industry employment by an average of 17.2 percent, while Oklahoma's industry employment contracted by 4.2 percent.



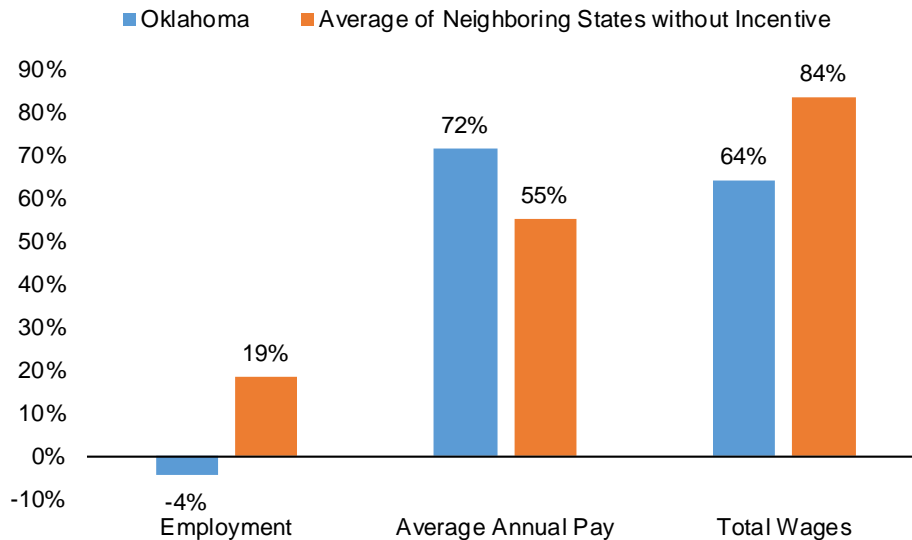
Table 1: Insurance Industry Employment Growth in Oklahoma and Neighboring States, 2001 to 2016

State	Employment Growth
Texas	30.3%
Arkansas	26.0%
Kansas	21.8%
Colorado	10.7%
Missouri	8.1%
New Mexico	6.4%
Oklahoma	-4.2%
Average excluding Oklahoma	17.2%

Source: Bureau of Labor Statistics Quarterly Census of Employment and Wages

The Home Office Tax Credit does not appear to have provided an advantage to Oklahoma over the last 15 years in terms of employment growth relative to neighboring states. Of neighboring states, Colorado is the only one that offers an incentive to home offices. If Colorado is excluded, examining employment, average annual pay, and total wage growth in Oklahoma compared to neighboring states without a home office incentive suggests that Oklahoma's incentive has not provided any net benefit.

Figure 2: Insurance Industry Growth, 2001 to 2016



Source: Bureau of Labor Statistics Quarterly Census of Employment and Wages

The effective credit percentage was reduced in 2010 as a result of excluding premium tax apportioned for pension funds from the calculation of the credit. This change reduced the value of the credit by about half. Despite this significant reduction, the insurance industry employment on a percentage basis has actually grown since that change (after declining the prior 10 years with a more significant credit).



Table 2: Employment Growth Before and After Credit Reduction

State	2001 to 2009	2010 to 2016
Texas	4.2%	26.3%
New Mexico	-7.9%	19.8%
Arkansas	5.2%	18.9%
Colorado	-0.6%	15.5%
Kansas	11.9%	10.2%
Missouri	-0.4%	9.2%
Oklahoma	-2.8%	3.1%
Average excluding Oklahoma	2.1%	16.6%

Source: Bureau of Labor Statistics Quarterly Census of Employment and Wages

Of course, that there may be other, exogenous variables that have impacted on these results. However, the credit, whether viewed in terms of Oklahoma performance or versus its peer states, does not appear to have had a significant positive impact on the industry in the State.

- Program benefits show little connection to employment growth.** The Oklahoma Insurance Department has data tracking employment reported by Home Office Tax Credit applicants since 2009. An analysis of employment change over this period relative to the change in total credit amounts is shown in the following table. The analysis suggests that the amount of credits provided to participating companies does not relate to employment growth. Between 2010 and 2015, there were four years when the State paid for a net decrease in employment. In 2012, for example, the State essentially paid over \$19,000 per lost job. In total, from 2009 to 2015, participating companies added 604 new jobs, and the total credit amount paid by the State grew by over \$6.2 million, resulting in a cost per new job of \$10,373.

Table 3: Job Creation and Credit Amount Comparison

Year	Total Credit Amount	Total Employees	Annual Change in Credit Amount	Annual Change in Employment	Credit Change per Employment Change (Absolute Value)
2009	\$14,673,798	5,370	-	-	-
2010	\$15,738,329	6,323	\$1,064,531	953	\$1,117
2011	\$16,849,045	5,829	\$1,110,716	(494)	\$2,248
2012	\$17,959,069	5,772	\$1,110,024	(57)	\$19,474
2013	\$18,831,786	5,626	\$872,717	(146)	\$5,978
2014	\$20,057,870	6,032	\$1,226,084	406	\$3,020
2015	\$20,938,807	5,974	\$880,937	(58)	\$15,189
Total			\$6,265,009	604	\$10,373

Source: Oklahoma Insurance Department

- It does not appear that companies are using a strategy of employing just enough people to meet program requirements.** On average, companies at each level of credit percentage employ well over the required amount.



Table 4: Distribution of Companies by Credit Percentage in 2015

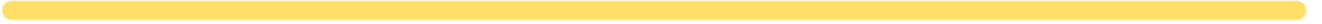
Credit Amount	Employee Threshold to Qualify	Number of Companies	Average Number of Employees Above Threshold
15%	200	3	37
25%	300	0	-
35%	400	3	54
50%	500	4	409

Source: Oklahoma Insurance Department

- **The program is a net cost to the State.** As discussed in the economic impact analysis, the industry has not grown in terms of employment over the last 10 years. Program costs continue to grow, even in years where employment has declined. The lack of a connection between employment growth and credit amounts awarded leaves no impact economically as a result of job creation. Since the economic impact appears insignificant, the cost to the State equals the amount it pays out in credits annually. Over the last five years (2011-2015), this amount has averaged over \$18 million.

Recommended Changes

- **Recommendation 1: If the intent of the State is to attract insurance industry jobs to Oklahoma, the State should tie the credit to job creation.** At present, the State may pay yearly credits for net decreases in employment. The State could calculate the credit amount as a percentage of payroll, or only allow the credit for companies that have created jobs (or at least retained them) over the last year.
- **Recommendation 2: Collect payroll data from companies receiving credits to improve future evaluations.** Future evaluations would be enhanced by collection of detailed data regarding payroll of companies qualifying for the credit. The only requirement when filing for the credit currently is reporting the number of employees at the company – which may be minimum wage workers as well as the home office general manager. More information regarding wages and job function could provide better evidence of the program’s economic impact. Indeed, it may well be that in some years with reductions in net jobs, payroll actually increased. That type of information is not currently required for payment of the credit.



Introduction



Overview

In 2015, HB2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The first set of 11 evaluations was conducted in 2016.

The Home Office Tax Credit is one of 12 incentives scheduled for review by the Commission in 2017. Based on this evaluation and their collective judgement, the Commission will make recommendations to the Governor and the State Legislature related to this incentive.

Incentive Characteristics

Oklahoma's Home Office Tax Credit was created in 1987. Insurance companies who establish or expand a home or regional home office in Oklahoma and hire at least 200 employees (for foreign insurers) and 400 employees (for insurers based in the State) are eligible for a credit against premium tax.¹ The credit amount ranges from 15 to 50 percent depending on the number of employees and whether the insurer is foreign or domestic.

In 2010, the calculation of the credit amount was adjusted to protect the amount of insurance premium tax apportioned for the Oklahoma Firefighters Pension and Retirement Fund, the Oklahoma Police Pension and Retirement System and the Law Enforcement Retirement Fund. Since the change, the credit percentage is applied to the amount remaining after 53 percent of the tax collected is allocated to these funds.

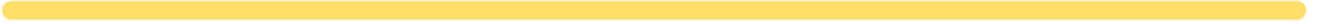
Criteria for Evaluation

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In this case, the legislative intent is not provided in statute. However, based on the characteristics of the incentive and its narrow focus on the insurance industry, it is reasonable to infer that the intention of the program is to attract insurance industry location and expansion in Oklahoma. The fact that the percentage of the credit is based on the number of full-time employees also suggests that employment is a key feature of the incentive.

To assist in a determination of program effectiveness, the Incentive Evaluation Commission has adopted the following criteria:

- Change in employment for eligible insurers before/after credit
- Distribution within the categories of number of full-time employees claimed
- Change in payroll for eligible insurers before/after credit
- Average wage for eligible insurers before/after credit
- Change in employment for industry versus other states without credit
- Return on investment – economic activity versus financial net cost

¹ In this context, foreign refers to insurers based outside Oklahoma

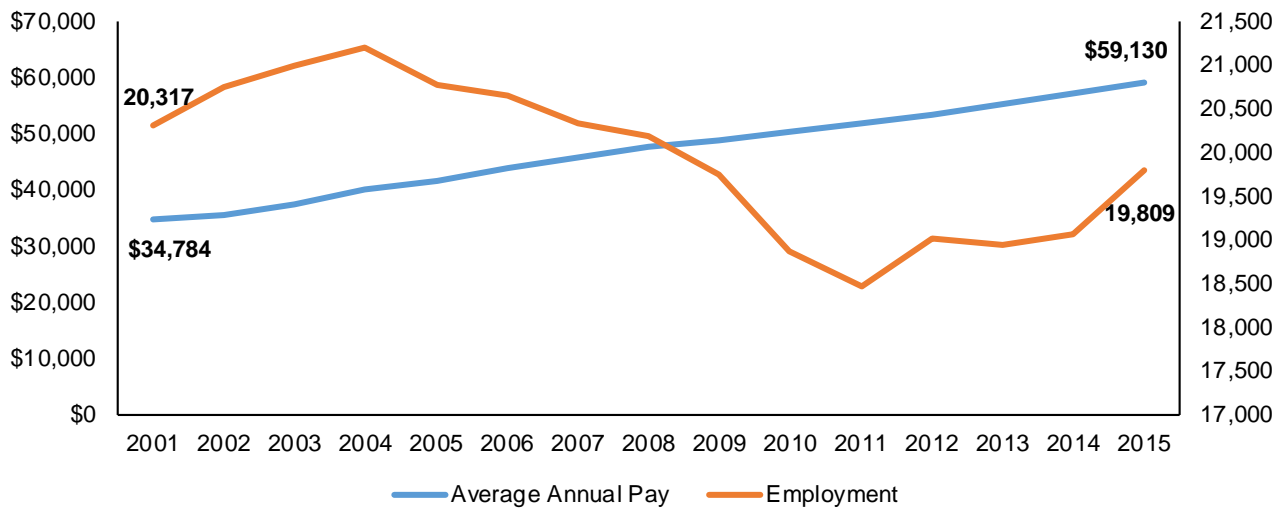


Industry Background



The U.S. insurance industry is a small but valuable portion of the nation's workforce. Insurance industry employment accounts for 1.9 percent of private employment in the U.S. In fact, the industry's share of private employment declined by 1.5 percent from 2001 to 2015. While the quantity of insurance industry jobs is small, the quality of insurance industry jobs (in terms of wages) is more substantial. Average annual pay for insurance industry employees, \$81,146, is 53 percent greater than the average private sector annual pay in the U.S.

Figure 3: Insurance Industry Employment and Average Annual Pay in Oklahoma, 2001 to 2015



Source: Bureau of Labor Statistics Quarterly Census of Employment and Wages

Oklahoma's insurance industry largely mirrors the national trends. Insurance industry employees make up less than 1.25 percent of total private employment in the State, and this share has declined by more than 10 percent from 2001 to 2015. At the same time, average annual pay in the industry is 33.5 percent higher than the average private sector annual pay, statewide. This wage premium is the highest it has been in the period from 2001 to 2015. Growth of the industry in Oklahoma (in terms of premiums written) has outpaced growth nationwide. A 2015 report from the National Association of Insurance Commissioners (NAIC) shows 10-year growth in the industry nationwide at about 17 percent while growth in Oklahoma over the same period was more than 47 percent.²

Although representing a small percentage of overall employment, the quality of the jobs has motivated some states to compete for insurance industry investment. One of the ways states can directly compete with one another for insurance industry investment is through credits or other incentives related to insurance premium taxes.

All but one state impose a tax on insurance premiums. In all but 10 states, these taxes are imposed in lieu of corporate income taxes.³ In general, the tax is imposed on gross premiums written, collected or received within the state. Insurance premium taxes are similar to a gross receipts tax and do not have a relationship to firm profitability. Insurance premium tax rates range from 0.5 to 4.35 percent, with the average being slightly

² National Association of Insurance Commissioners, 2014 Competition Database Report, 2015.

³ In states with both an income tax and an insurance premium tax, they provide some mechanism to limit double taxation, such as a premium tax credit for income taxes or a cap related to in-state premiums.



above 2 percent.⁴ The Oklahoma insurance premium tax is 2.25 percent per insurance policy premium up to \$100,000 and an additional one-tenth of one percent of insurance policy premium over \$100,000 per year.⁵

From a fiscal policy perspective, insurance premium tax is a reliable source of revenue. Collections are relatively stable over time compared to the more cyclical corporate income tax. The stability of collections is beneficial to states, as premium taxes accounted for an average of 2.6 percent of total state revenues in FY2016. In Oklahoma, they accounted for 3.8 percent (over \$322 million) of total state tax revenue in FY2016.⁶

⁴ NCSL Task Force on State and Local Taxation, "State Taxation of the Insurance Industry" August 19, 2014.

⁵ National Association of Insurance Commissioners, December 2016, accessed electronically at http://www.naic.org/documents/industry_ucaa_retaliatory_OK_retaliatory.pdf

⁶ U.S. Census Bureau Annual Survey of State Government Tax Collections 2016



Administration and Use of the Incentive



Technical and Administrative Issues

The Oklahoma Insurance Department (Department) takes a lead role in administering the credit. The essential components of program administration are summarized below:

1. **Eligibility.** Insurance companies that have established a regional or home office in the State with at least 200 employees for foreign insurers and 400 employees for insurers based in Oklahoma qualify for the credit.
2. **Determining Credit Amount.** Eligible insurance companies qualify for varying credit amounts depending on the number of employees. The credit amount depends on the number of employees and whether the insurance company is foreign or domestic.⁷ The following table summarizes credit amounts and requirements:

Table 5: Tax Credit Percentages and Requirements

Qualifying Insurers	Number of Full-time Employees	Credit Percentage
Foreign Insurers Only	200 to 299	15%
Foreign Insurers Only	300 to 399	25%
Foreign and Domestic Insurers	400 to 499	35%
Foreign and Domestic Insurers	500 or more	50%

For the first year the credit is claimed, the company must maintain the regional home office continuously from on or before August 1 of that year through the end of the calendar year. In subsequent years, the home office must be maintained for the entire calendar year.

In 2010, the calculation of the credit amount was adjusted to protect the amount of insurance premium tax apportioned for the Oklahoma Firefighters Pension and Retirement Fund, the Oklahoma Police Pension and Retirement System and the Law Enforcement Retirement Fund. Since the change, the credit percentage is applied to the amount remaining after 53 percent of the tax collected is allocated to these funds.

This new calculation means that a 15 percent tax credit applied to a qualified insurer's full premium tax liability is now applied to 47 percent of the total liability. This significantly reduces the effective tax credit percentage. The table below shows how the change impacts the effective rate at each tax credit level:

Table 6: Nominal and Effective Tax Credit Amounts

Nominal	Effective
15%	7.05%
25%	11.75%
50%	23.50%

3. **Reporting.** The Department maintains records of companies enrolled in the program and associated credit amounts.

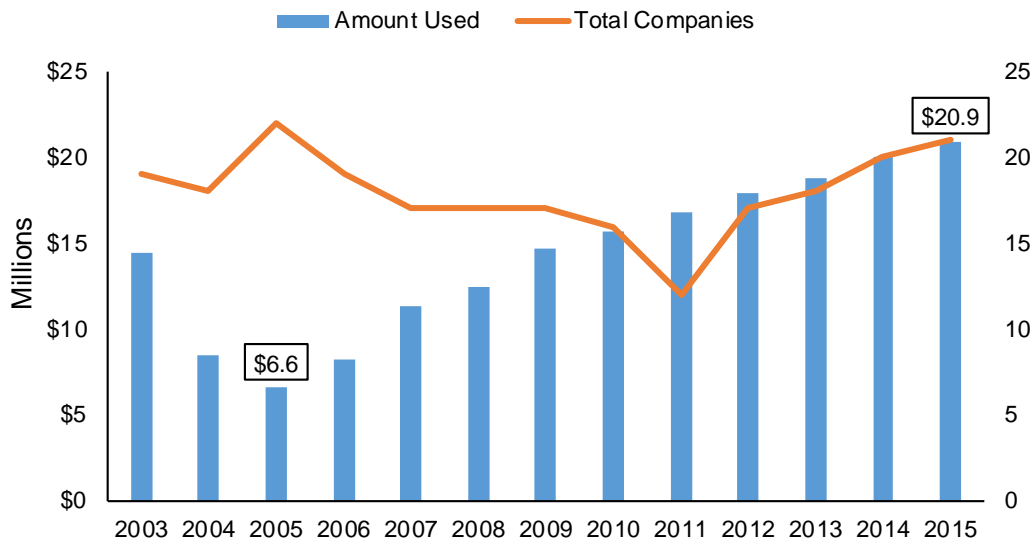
⁷ The full-time employee count may include employees from multiple offices in the state associated with one insurance group



Use of the Incentive

Even with the change in calculation of the credit in 2011, the amount of credits used has increased consistently in recent years; the 2015 total credits claimed (\$20.9 million) is more than three times the total credits claimed in 2005 (\$6.6 million). Meanwhile, the number of companies receiving the credits has been relatively stable:

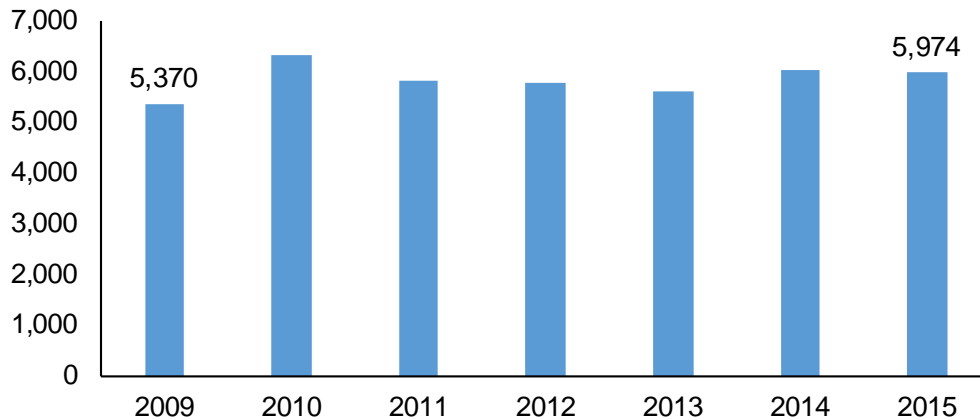
Figure 4: Amount of Home Office Tax Credits Used, 2003 to 2015



Source: Oklahoma Insurance Department

From 2009 to 2015, the total number of employees reported on Home Office Tax Credit applications has increased by 11 percent.

Figure 5: Employees Reported on Home Office Tax Credit Applications, 2009 to 2015

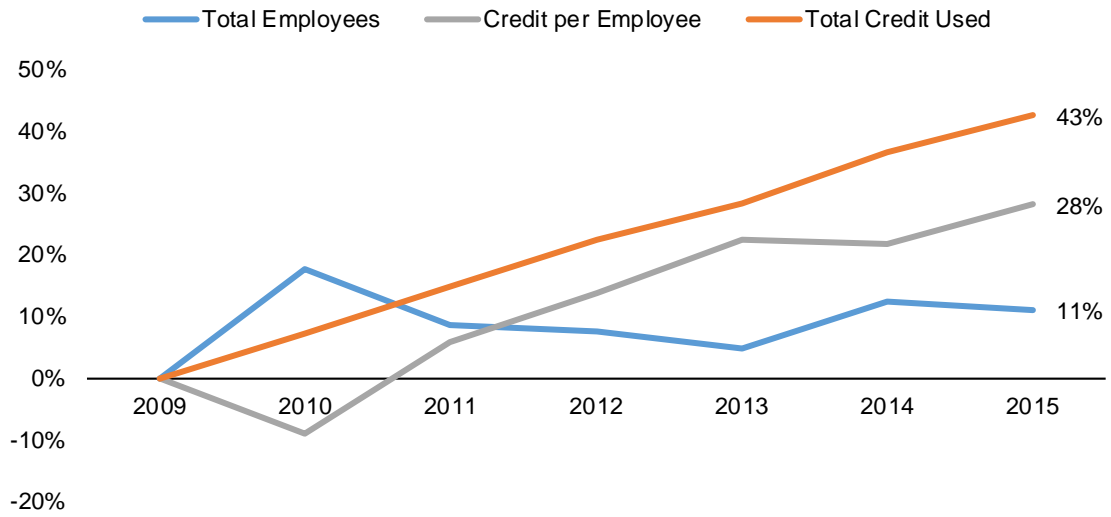


Source: Oklahoma Insurance Department

While employment growth of 11 percent is notable, it is significantly less than the 43 percent growth in the total credit amount claimed over the same period. The following chart illustrates how growth in the total amount of credit used has grown at a steady rate since 2009, which does not appear to be connected to employment growth.



Figure 6: Cumulative Growth in Employees, Credits Used and Credit per Employee, 2009 to 2015



Source: Oklahoma Insurance Department



Fiscal and Economic Impact

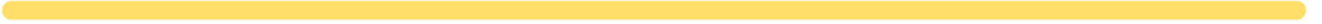


Economic Impact

Over the past 10 years, employment in Oklahoma's insurance sector has declined while tax credits have increased. Because the tax credit is not directly linked to net new employment, does not have a maximum credit per job, and does not have a time limit, it is not possible to determine how this credit has influenced long-term employment patterns. Therefore, it is not possible to run a traditional economic impact analysis based on net new employment in this sector. It is likely that the insurance sector is appropriately sized to meet consumer demand within Oklahoma. It is unclear how this program, based on policies written for Oklahoma consumers, would influence employment patterns for positions not linked to selling or servicing policies in Oklahoma.

If the tax credit was ended, there are a few logical outcomes. First, there might be a reduction in Oklahoma insurance sector employment if relocating or shifting employment to another state offered substantially lower costs. Second, insurance companies might absorb the loss of these incentives and not pass along their higher costs related to the tax to consumers through higher premiums. Third, the insurance companies might pass along the loss of incentives to consumers in the form of higher premiums. If this occurs, consumer might buy less expensive coverage, pay the higher costs or shop around for lower priced coverage. If consumers pay more for the same insurance product with no additional benefits, residents will have less money to spend in the economy on other services and goods. Finally, all of the above might occur in varying degrees with no meaningful negative or positive impact on the economy.

Based on the available information, there is insufficient data to accurately estimate or verify the total economic or tax revenue impacts of the home office tax credit.



Incentive Benchmarking



Benchmarking

Of the 49 states that levy an insurance premium tax, 44, including Oklahoma, levy a general premium tax rate. The remaining states apply different rates depending on what type of premium is written. Of the 44 states with a general premium tax, Oklahoma is tied for having the ninth highest rate. Oklahoma's rate is also the third highest among neighboring states with a general insurance premium tax.

Table 7: Neighboring states insurance premium tax rates

State	Insurance Premium Tax Rate
New Mexico	3.00%
Arkansas	2.50%
Oklahoma	2.25%
Colorado	2.00%
Kansas	2.00%
Missouri	2.00%

Colorado, Maryland, Nevada and South Dakota were found to have programs comparable to Oklahoma's Home Office Tax Credit. The distinguishing characteristics of each program fall into four categories: qualifications, benefit type, benefit amount, and spending caps.

Qualifications: None of the comparable programs require a certain number of jobs to be created in order to receive benefits.

Benefit Type: Maryland and Nevada offer a tax credit. Colorado and South Dakota offer a reduced rate and tax deduction.

Benefit Amount: Oklahoma's benefit amount is relatively low compared to other states. The maximum benefit in Oklahoma is 50 percent of premium tax. However, the effective percentage is 23.5 percent, due to apportionments made to pension funds. Colorado, Nevada, and South Dakota offer 50 percent of full premium tax. Nevada and South Dakota also offer an amount up to an additional 30 and 20 percent of premium tax, respectively. However, Nevada's program has an aggregate spending cap of \$5 million, which reduces the overall amount of benefit available. After discounting Nevada's program due to its cap, Oklahoma incentive provides the second lowest benefit amount among the comparison states.

Cap: Maryland and Nevada cap aggregate program spending at \$1 million and \$5 million, respectively.

Overall, Oklahoma's Home Office Tax Credit distinguishes itself among the comparison group by emphasizing job creation in its requirements. Oklahoma's effective credit percentages are significantly lower than Colorado and South Dakota. However, Oklahoma's tax credit is more generous than Maryland and Nevada, because there is no cap on its credit.

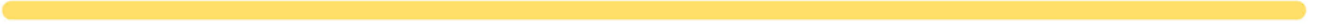
Benchmarking Program Evaluations

From 2003 to 2007, Iowa gradually reduced its insurance premium tax rate from 2 percent to 1 percent. In a 2009 report, the state evaluated the impact of this change on state revenue and employment.⁸ It found that the State experienced significant revenue losses as a result of the lower rates. Over a five year period from 2004 to 2008, while the rate was being reduced, the report estimates that total insurance premium tax collections were 28 percent, or \$245.4 million, less than they would have been without the rate reduction.

⁸ Iowa Legislative Services Agency, "Impact of the Insurance Premium Tax Rate Reduction" January 21, 2009.



However, the state did see benefits in the form of greater employment in the industry. Prior to the tax reduction, there were nearly 28,000 employees in the insurance industry in Iowa. By 2007, this number increased to over 30,000. Furthermore, the state saw its share of national insurance industry employment increase. It is notable that the Des Moines, Iowa MSA is the corporate headquarters of multiple insurance companies, including Principal Financial Group, a Fortune 250 corporation.



Appendices



Appendix A: Home Office Tax Credit Benchmarking

Home Office Tax Credit Benchmarking					
	Oklahoma	Colorado	Maryland	Nevada	South Dakota
Job Creation Requirement	Yes	No	No	No	No
Home Office	Qualify	Qualify	Qualify	Qualify	Qualify
Regional Office	Qualify	Qualify	Do not qualify	Qualify	Qualify
Benefit Type	Tax Credit	Reduced Rate	Tax Credit	Tax Credit	Tax Deduction
Benefit Amount	15 to 50 percent of premium tax*	50 percent of standard premium tax	Amount of Retaliatory Tax	50 percent of premium tax, plus an amount equal to ad valorem tax on the property, up to an additional 30 percent of premium tax	50 percent of premium tax, plus an amount equal to ad valorem tax on the property, up to an additional 20 percent of premium tax
Aggregate Program Cap	None	None	\$1 million	\$5 million	None

*Amount depends on number of full-time employees and whether the insurer is foreign or domestic. Credit is calculated after an allocation is made to Police Pension and Fire Retirement Funds