Part D. Tax Exemption for Insurance Companies

REPEAL TAX EXEMPTION FOR CERTAIN INSURANCE COMPANIES

General Explanation

Chapter 12.14

Current Law

Current law exempts from Federal income tax a large and diverse group of nonprofit organizations. These organizations are, however, taxable on income received from the conduct of business that is unrelated to the organization's exempt purpose. Although the sale of insurance by tax-exempt organizations generally is an unrelated trade or business, there are numerous organizations that engage in the insurance business without tax liability. Current law expressly provides a tax exemption for the insurance activities of some organizations, including: certain fraternal beneficiary societies that provide for the payment of insurance benefits to their members; voluntary employee beneficiary associations that provide insurance benefits to their members; local benevolent life insurance associations; mutual insurance companies or associations (other than life or marine) if the gross amount received from certain sources does not exceed $150,000; trusts for the payment of supplemental unemployment benefits; Black Lung trusts; veterans' organizations; and shipowners' protection and indemnity associations. In addition, some organizations that sell insurance have been held to be tax exempt under provisions of law exempting from tax religious, charitable, or educational organizations and social welfare organizations.1/

Reasons for Change

The statutory tax exemptions for the organizations listed above generally were enacted at a time when large parts of the United States were rural and agricultural, and when many individuals and businesses were unable to obtain insurance from commercial companies. Similarly, tax-exempt status was recognized by the courts and the Internal Revenue Service for certain organizations because they met a need that was not met by the commercial sector. These organizations generally were small and had little income.

1/ Where an insurance organization's exempt status is not expressly mandated by statute but rather has been recognized under a more general provision for exempt status, the Internal Revenue Service has authority to revoke the organization's exemption if it is no longer justified.

Today, tax-exempt insurance companies are generally indistinguishable from their taxable counterparts. They sell the same products as taxable insurance companies and compete with taxable companies for business. Several insurance companies that are exempt from tax rank among the largest insurance companies in the United States.

All businesses that sell insurance should be treated equally. Retention of tax-exempt status for some insurance companies would give those companies an unfair competitive advantage. The absence of a tax burden on these companies may be reflected in lower premiums charged to policyholders, thereby giving individuals who are able to purchase insurance from one of these companies an advantage over other individuals.

Proposal

Existing tax exemptions for insurance businesses would be repealed. In general, these insurance businesses would be taxed under the rules applying to taxable corporations. Any organization qualifying as a life insurance company or property and casualty insurance company would be taxed under the rules applying to that type of company. Special rules would be provided for certain organizations that are not subject to the same system of regulation for State law purposes as other insurance companies or that have relatively small insurance activities.

The providing of insurance at less than cost to a class of charitable recipients would continue to be recognized as a charitable activity entitled to exemption from Federal income tax.

Effective Date

The proposal would be phased in over a five-year period, starting with the first taxable year beginning on or after January 1, 1986.

Analysis

Nonprofit organizations providing insurance in competition with taxable stock and mutual insurance companies would be placed on a par with their competitors. Elimination of the tax exemption would end tax-induced distortions that favor the provision of insurance through tax-exempt organizations and that favor individuals who have access to insurance sold by these organizations.