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TO THE HOUSE COMMITTEE ON
CONSUMER PROTECTION & COMMERCE

TWENTY-FOURTH LEGISLATURE
Regular Session of 2008

Thursday, January 24, 2008
2:00 p.m.

TESTIMONY ON HOUSE BILL NO. 2248 – RELATING TO INSURANCE.

TO THE HONORABLE ROBERT HERKES, CHAIR, AND MEMBERS OF THE
COMMITTEE:

My name is J. P. Schmidt, State Insurance Commissioner (“Commissioner”),
testifying on behalf of the Department of Commerce and Consumer Affairs
 (“Department”).

The Department supports this measure.

The purpose of this bill is to amend the definitions of “insurer” and “reciprocal
insurer” in the Insurance Code, Hawaii Revised Statutes chapter 431.

In *Director of Taxation v. Medical Underwriters of California*, 115 Haw. 180
(2007), the Hawaii Supreme Court ruled that Medical Underwriters of California (“MUC”)
was not an insurance company exempt from payment of the Hawaii general excise
 (“GE”) tax. MUC is the attorney-in-fact of Medical Insurance Exchange of California
 (“MIEC”), a reciprocal insurance exchange, and the managing agent for Claremont
 Liability Insurance Company (“CLIC”). Based on its position that it was an “insurance
 company” exempted from the GE tax, MUC did not file GE tax returns and did not pay
 GE taxes on funds received in exchange for its services rendered to MIEC and CLIC.

Under current law, the reciprocal insurer is required to appoint an attorney-in-fact through which the reciprocal insurer operates. The reciprocal insurer is entitled to the GE tax exemption. But if its attorney-in-fact is taxed anyway, that contradicts the exemption statute.

The intent of this measure is to ensure that: (1) the reciprocal insurer and its attorney-in-fact are treated as a single entity for tax purposes; and (2) the general excise ("GE") tax exemption applies to "insurers", rather than to "insurance companies".

We thank this Committee for the opportunity to present testimony on this matter and request your favorable consideration.

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SUBJECT: GENERAL EXCISE, Exempt reciprocal insurer and attorneys-in-fact

BILL NUMBER: SB 2315; HB 2248 (Similar)

INTRODUCED BY: SB 2315 by Kokubun by request; HB 2248 by Herkes

BRIEF SUMMARY: Amends HRS section 237-29.7 to replace the term insurance companies with insurers and stipulate that a reciprocal insurer and its attorney-in-fact shall be considered singularly as an insurer.

Makes conforming amendments to HRS sections 431:1-202 and 431:3-108.

EFFECTIVE DATE: Taxable years ending after July 1, 2008

STAFF COMMENTS: These measures propose that a reciprocal insurer and its attorney-in-fact shall be considered as a single entity to prevent the imposition of the general excise tax on the gross proceeds received by its attorney-in-fact.

Should attorneys-in-fact be treated differently from attorneys who are on contract with a taxpayer who is not exempt from general excise tax? Should the exemption for insurance companies carry over to attorneys they hire to represent them because they are considered as part of and essential to the insurance company doing business in Hawaii?

It should be remembered that the general excise tax is an imposition for the privilege of doing business in the state. While the attorney-in-fact is performing a service and receives remuneration for his services performed for the reciprocal insurance company, the question should be whether or not the attorney-in-fact is considered part of the insurance company and should also enjoy the exemption.

It is being argued that reciprocal insurers generally do not have employees to do the business of the reciprocal insurer relying instead on the attorney-in-fact to run the business of the reciprocal insurance company. In fact state law requires an attorney-in-fact for such insurance companies. As drafted, the measure could be abused by an attorney-in-fact who is not only an attorney-in-fact for a reciprocal insurance company but also is holding a letter appointing him as an attorney-in-fact for a client who is not a reciprocal insurance company. To tighten the language, consideration should be given to adding language that applies the general exemption to amounts received by the attorney-in-fact that have previously been subject to the insurance premiums tax.

The question to ask is how does an attorney-in-fact for a reciprocal insurance company differ from an attorney-in-fact for another business entity? Banks are the other major entity exempt from the general excise tax. Should an attorney-in-fact for a bank, that does business in this state, be exempt from the general excise tax?

well? It should be remembered that while insurance companies and reciprocal insurance companies are exempt from the general excise tax, they do, in fact, pay state insurance
SB 2315; HB 2248 - Continued

premiums tax. If, in fact, the law requires reciprocal insurance companies to operate with an attorney-in-fact then the exemption from the general excise tax should extend only to that income that had previously been subject to the in-lieu insurance premiums tax.

Given the fact that the reciprocal insurer is an unincorporated aggregation of subscribers operating through an attorney-in-fact arrangement it is similar to that of an unincorporated merchants association exempted under HRS section 237-243.3(9). That section exempts from the general excise tax, amounts received as dues by an unincorporated merchants association from its membership for advertising media, promotional, and advertising costs for the promotion of the association for the benefit of its members as a whole and not for the benefit of individual member or group of members less than the entire membership, whereby the attorney-in-fact would be treated similarly as the unincorporated merchants association who provides services to its members, while preventing the double taxation of proceeds of the attorney-in-fact. In that way, one can be assured that the moneys paid to the attorney-in-fact by the unincorporated members of a reciprocal insurer were indeed subject to the insurance premiums tax.

Digested 1/22/08

TESTIMONY ON H.B. NO. 2248
RELATING TO INSURANCE

HOUSE COMMITTEE ON CONSUMER PROTECTION & COMMERCE

Rep. Robert N. Herkes, Chair
Rep. Angus L.K. McKelvey, Vice Chair

Thursday, January 24, 2008, 2:00 p.m.
State Capitol, Conference Room 325

My name is Gerald C. Yoshida. I am testifying on behalf of Medical Insurance Exchange of California ("MIEC") and Medical Underwriters of California ("MUC").

By way of background, MIEC was formed as a reciprocal insurer in California by doctors, for doctors, during the medical malpractice crisis during the mid to late 1970s. MIEC currently insures about 1100 private practice physicians in Hawaii, which accounts for roughly 30-35% of Hawaii's private practice physicians. MUC is MIEC's attorney-in-fact.

The purpose of this bill is to recognize a reciprocal insurer and its attorney-in-fact as a single entity that is not subject to double taxation under Hawaii law.

MIEC strongly supports this bill.

Reciprocal insurers, unlike stock or mutual insurers that are incorporated entities, provide insurance through unincorporated associations of individuals, partnerships, or corporations called "subscribers." By law, subscribers of the reciprocal insurer must operate through an attorney-in-fact common to all of the subscribers. As a result, a reciprocal insurer and its attorney-in-fact are virtually indistinguishable.

Insurance companies in Hawaii are taxed in lieu of most state taxes because they are subject to the tax on insurance premiums under Hawaii Revised Statutes ("HRS") §431:7-204. HRS §237-29.7 exempts "insurance companies" from paying the general excise tax, as long as the insurance company has paid the insurance premium tax. Because the term "insurance companies" is not defined in chapter 237, HRS, or chapter 431, HRS (the "Insurance Code"), the law has been interpreted not to apply to reciprocal insurers and their attorneys-in-fact. The problem is compounded because HRS §237-29.7 does not expressly define that the reciprocal insurer's attorney-in-fact is part of the reciprocal insurer.

The Hawaii Insurance Division has long recognized a reciprocal insurer and its attorney-in-fact as a single entity for tax purposes. Notwithstanding that our client MIEC has consistently paid its

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share of premium taxes under Hawaii law, MIEC and MUC have been singled out and subjected to double taxation. This ultimately affects the premium rates paid by subscribers who are private practice physicians in Hawaii.

Thank you for this opportunity to submit testimony on this bill and request your favorable consideration.

Respectfully submitted:

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