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TO THE SENATE COMMITTEE ON COMMERCE,
CONSUMER PROTECTION, AND AFFORDABLE HOUSING

TWENTY-FOURTH LEGISLATURE
Regular Session of 2008

Tuesday, March 11, 2008
9:00 a.m.

TESTIMONY ON HOUSE BILL NO. 2248, H.D. 2 – RELATING TO INSURANCE.

TO THE HONORABLE RUSSELL KOKUBUN, 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, with one suggested amendment.

The purpose of this version of the bill is to amend: (1) the definitions of “insurer”
and “reciprocal insurer” in the Insurance Code, Hawaii Revised Statutes (“HRS”)
chapter 431; and (2) the in-lieu provision in HRS § 431:7-204 by defining “attorney-in-
fact” and by clarifying that the attorney-in-fact of a reciprocal insurer is subject to all
taxes, except for taxes on income derived from its principal business as attorney-in-fact.
This version of the bill has a defective effective date of July 1, 2020.

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 tax (“GET”). 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 understanding that it was an "insurance company" exempted from the GET, MUC did not file GET returns and did not pay GET 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 GET 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 tax exemption applies to "insurers", rather than to "insurance companies".

We thank this Committee for the opportunity to present testimony on this matter and respectfully request that the Committee pass an S.D. 1 with an effective date of July 1, 2008.

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**SENATE COMMITTEE ON COMMERCE, CONSUMER PROTECTION &
AFFORDABLE HOUSING**

**TESTIMONY REGARDING HB 2248 HD 2
RELATING TO INSURANCE**

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 11, 2008
TIME: 9:00AM
ROOM: 229

This legislation redefines the definition of insurance companies that qualify for the general excise tax exemption for insurers.

The Department of Taxation (Department) supports this legislation at this time.

This legislation will result in a revenue loss of approximately \$3.3 million per year. Using data provided by DCCA, the Department obtained premium tax collections paid in 2006. To obtain the tax base associated with these tax collections, a premium tax rate of 2.75% was assumed. The 4% general excise tax rate on the insurance tax base was assessed to approximate the taxes paid by attorneys-in-fact.



**Property Casualty Insurers
Association of America**

Shaping the Future of American Insurance

1415 L Street, Suite 670, Sacramento, CA 95814-3972

To: The Honorable Russell S. Kokubun, Chair
Senate Committee on Commerce, Consumer
Protection, and Affordable Housing

From: Samuel Sorich, Vice President

RE: **HB 2248 HD2 – Relating to Insurance**
PCI Position: Support

Date: Tuesday, March 11, 2008
9:00 a.m.; Conference Room 229

The Property Casualty Insurers Association of America (PCI) is an association of property/casualty insurers. There are more than 100 PCI member companies doing business in Hawaii. PCI members are responsible for approximately 45 percent of the property/casualty insurance premiums written in Hawaii.

PCI supports HB 2248 HD 2 because the bill provides fair treatment to reciprocal insurers and their attorneys-in-fact. The bill assures that reciprocal insurers and their policyholders are given the same exemption from the general excise tax on gross premiums that is extended to insurers that operate under other business structures.

HB 2248 HD 2 is fair, reasonable and good public policy. PCI requests the committee to vote Yes on the bill.

TESTIMONY ON H.B. NO. 2248, H.D. 2
RELATING TO INSURANCE

SENATE COMMITTEE ON COMMERCE, CONSUMER PROTECTION, &
AFFORDABLE HOUSING

Sen. Russell S. Kokubun, Chair
Sen. David Y. Ige, Vice Chair

Tuesday, March 11, 2008, 9:00 a.m.
State Capitol, Conference Room 229

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; however, we respectfully request that its effective date be changed to July 1, 2008.

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 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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