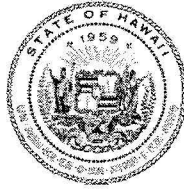


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HOUSE COMMITTEE ON FINANCE

TESTIMONY REGARDING HB2759 HD 1 RELATING TO GENERAL EXCISE TAX

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)

DATE: FEBRUARY 22, 2008

TIME: 3:30PM

ROOM: 308

This legislation extends the General Excise Tax (GET) exemption currently allowed for nonprofit hospitals to include for-profit hospitals.

The Committee on Health amended the measure to allow the exemption only for for-profit hospitals with certain patient requirements.

The Department of Taxation (Department) takes **no position** on this legislation, other than its current drafting will have the vast unintended impact of exempting currently taxable activities of a hospital from the GET.

Under the current structure of the GET, an entity that is nonprofit, such as a hospital, is only exempt to the narrow extent of its charitable purpose. For example, a hospital is not taxed on the services of providing immediate healthcare, such as surgery proceeds. **However a nonprofit hospital is subject to GET on all unrelated business income.** An example of activities subject to GET taxable activity carried out by a nonprofit hospital would be parking fees; sales of food in a cafeteria; gift shop sales; certain fundraising; and other activities that derive revenue from activities other than purely hospital services.

This legislation will effectively exempt ALL nonprofit hospital activity from the GET, regardless of whether the activity is related to its exempt purpose. **The reasoning behind any exemption from the GET is because it accommodates the charitable pursuits—not the profit pursuits. This bill will eliminate this logic for all hospitals, public or private** (assuming the private hospitals qualify). This legislation will impact all hospitals in Hawaii with currently taxable GET activity, which could theoretically be all hospitals in the state.

Department of Taxation Testimony
HB 2759 HD 1
February 22, 2008
Page 2 of 2

As stated, any currently exempt hospital in the State stands to benefit from this legislation on currently taxable goods or services provided outside the hospital's charitable purpose. **Therefore, this legislation will result in a revenue loss of approximately \$6.3 million per year.**

L E G I S L A T I V E

TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Exempt hospitals

BILL NUMBER: HB 2759, HD-1

INTRODUCED BY: House Committee on Health

BRIEF SUMMARY: Amends IIRS section 237-23 (6) to provide that the general excise tax shall not be imposed on nonprofit and for-profit hospitals that provide services to an annual patient population consisting of 60% or more uninsured, Medicaid, and Medicare patients.

EFFECTIVE DATE: July 1, 2008

STAFF COMMENTS: Under current law nonprofit hospitals, infirmaries and sanitarium are not taxable under the general excise tax law with respect to gross income realized from the provision of healthcare services. The current exemption applicable to hospitals, infirmaries, etc., recognizes that these facilities are of a nonprofit nature. This measure extends the exemption to those hospitals that are of a profit-making nature provided the non-profit and for-profit hospitals provide services to patients consisting of 60% or more uninsured, Medicaid, and Medicare patients.

Granting an exemption for one type of profit making facility, as proposed, does not promote horizontal equity, that is, in the entire universe of service providers, why should one type of service be singled out for an exemption as opposed to other services which may be just as important?

If the legislature believes that the proposed exemption from the 4% tax will reduce the cost of operating a hospital in the state, note that the imposition of the 4% tax is not one of the primary factors behind these costs. Government regulations and malpractice insurance have greatly added to such costs.

The components of medical care costs are many and varied including the cost of facilities, training, availability of personnel, tort possibilities and the attendant cost of liability insurance and very expensive equipment for treatment. Certainly a major cost element is the income of the physician, nurse, or technician - but of the total amount certainly the 4% tax is not as large a cost factor as these basic costs. Rather than creating a discriminatory exemption for profit-making activities, lawmakers should explore the other cost elements. Areas which need more attention are the growing litigious attitude toward the medical profession and the limited pool of medical support personnel.

Finally, one has to ask what sort of precedent does this set that may start an avalanche of requests. For example, there are several for-profit companies which provide social and psychological services to populations that are also served by nonprofit social service agencies and compete for state contracts such as Hawaii Behavioral Health Corporation and The Institute for Family Enrichment. Since they do serve a distressed population, should they also be granted an exemption from the general excise tax? And if it is a for-profit corporation then regardless of the population they serve, the for-profit is in business to make a profit for its owners. How different is that from a store that services the catchment area of Kalihi where

HB 2759, HD-1 - Continued

poverty is synonymous with that area of Honolulu? Should, say, a grocery store in that part of down be given a general excise tax exemption just because their customers are poor even though their prices are higher than Costco or Safeway? The owners of the for-profit hospitals that secure this exemption will be laughing all the way to the bank on the backs of all other taxpayers. Is that really fair?

Digested 2/21/08



HAWAII MEDICAL CENTER

House Committee on Finance
February 22, 2008, 3:30 PM, House Conference Room 308
House Bill No. 2759

Chair Oshiro and Honorable Members of the Committee on Finance:

Aloha kakou! I am Dr. Danelo Canete, Chief Executive Officer of Hawaii Medical Center (HMC). I thank you for the opportunity to testify in favor of House Bill 2759.

This bill would extend the general excise tax exemption for non-profit hospitals, infirmaries, and sanitariums to for-profit hospitals that provide similar services. HMC is struggling to provide services to a large number of uninsured patients, and Medicare and Medicaid patients whose government reimbursements do not generally cover the cost of care. Currently, 70% of HMC's patients are uninsured, or on Medicare or Medicaid, compared to about 55% at other local hospitals.

This exemption is necessary to help HMC to continue its operations and provide employment for over 1000 members of our community, while also continuing to provide medical services to the poor.

The survival of Hawaii Medical Center is critical, as we service 8,000 inpatients for over 75,000 patient days annually. This does not include the thousands of outpatients that are also served annually and the unique services provided by HMC that other hospitals are not able to absorb. In addition, HMC employees contribute hundreds of thousands of dollars in federal and state income taxes.

One year ago, I was one of more than 100 local physicians who came together to not only save the former St. Francis Medical Centers but also to help perpetuate their Catholic values. We know the Sisters' mission was to provide service to the underserved of the State of Hawaii. However, even with its nonprofit and tax-exempt status, St. Francis was in serious financial difficulty due to serving this patient population.

My colleagues and I took the unusual step of purchasing the hospital because we did not want to see our community lose these important institutions, nor did we want to deprive our patients of affordable health care. In addition, we did not want to see our community lose this organization's unique services that are

based on the moral and ethical values of serving the poor and needy that had always been the mission of the Sisters of St. Francis.

When our doctors assumed the management of the hospitals, we found they were in even worse financial shape than had been anticipated. HMC was forced to make hard decisions and difficult sacrifices to keep the hospitals going. We have worked long and hard to improve our operations and become more efficient.

I recognize you are faced with many competing demands for limited state resources. HMC is requesting this consideration in order for HMC to continue to serve its high percentage of underserved and needy residents of our state. We are determined to keep HMC afloat and to continue to serve the financially challenged. By extending to Hawaii Medical Center the same excise tax exemption already enjoyed by other hospitals in the state, you would be making a wise investment in health care for the people of Hawaii.

All Hawaii hospitals are struggling financially. But all the other hospitals are tax exempt and HMC serves a higher percentage of government insured patients compared to others. If we are going to solve the health care crisis that confronts our state, it is going to take a bold vision, creative innovation and timely investment, both public and private. Please help lead the way by approving reasonable excise tax relief to those Medical Centers that provide medical services to the underserved.

Thank you. I would be happy to answer any questions you may have.