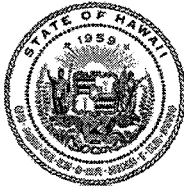


LINDA LINGLE  
GOVERNOR

JAMES R. AIONA, JR.  
LT. GOVERNOR



KURT KAWAFUCHI  
DIRECTOR OF TAXATION

SANDRA L. YAHIRO  
DEPUTY DIRECTOR

STATE OF HAWAII  
DEPARTMENT OF TAXATION  
P.O. BOX 259  
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510  
FAX NO: (808) 587-1560

## SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

### TESTIMONY REGARDING HB 2778 HD 2 SD 1 RELATING TO TAX CREDITS

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

**DATE: MARCH 18, 2008**

**TIME: 1:15PM**

**ROOM: 224**

---

This bill creates an income tax credit to encourage Hawaii employers to purchase qualified long-term care insurance for their employees. This tax credit is phased-in over two years and will be equal to the greater of \$500 or 50% of qualified long-term care premiums paid per employee.

The Senate Committee on Human Services & Public Housing amended the measure by inserting a current effective date applying to taxable years beginning after December 31, 2008.

The Department of Taxation (Department) **strongly supports** this measure.

#### **I. THE NEED FOR LONG-TERM CARE INSURANCE CONTRACTS.**

The future of long-term care for Hawaii's senior and adult disabled population is one of the most critical health issues facing Hawaii in the twenty-first century. Persons sixty years of age and older presently account for almost one-fifth of the adult population in the State. By 2020, they will constitute more than one-fourth of Hawaii's adult population.

The rapid growth of the elderly and disabled populations will result in extraordinary demands on the delivery of long-term care services. While the majority of persons receiving long-term care are older adults, entire families are affected by the psychological, financial, and social costs of long-term care provided to those who are limited in the activities of daily living. As of 2003, the statewide average annual cost of a room in a skilled nursing facility was \$105,028 for a private room and \$95,597 for a semi-private room.

When employees provide long-term care to family members in need, businesses incur costs for lost productivity due to employee absenteeism, for replacing the absent employee, and in supervising temporary replacement workers. According to a 1997 study conducted by the National

Alliance for Caregivers and the Metlife Mature Market Institute, the total cost of lost productivity to businesses nationally from these factors exceeded \$29 billion annually.

## **II. EMPLOYER TAX CREDIT**

This employer long-term care tax credit accomplishes the following:

- Encourages employers to purchase qualified long-term care insurance contracts for their employees;
- Ensures that such qualified long-term care insurance contracts provide a requisite level of home and community-based care in addition to coverage for long-term care in intermediate care facilities and skilled nursing facilities;
- Extends long-term care insurance coverage to those individuals who generally could not otherwise obtain coverage and/or who could not obtain reasonably priced long-term care insurance coverage;
  - On most employer-sponsored plans, the insurers use less rigorous standards for determining a full-time employee's eligibility for coverage, which is a practice commonly referred to as "simplified short form underwriting."
  - Thus, a substantial number of Hawaii residents who could ordinarily not obtain coverage on an individual plan (or who could not obtain reasonably priced long-term care insurance coverage) will be able to obtain coverage on an employer-sponsored policy because of the less restrictive underwriting.
  - The employer's group plan allows a long-term care insurer to spread the underwriting risk among a group of covered individuals who work full-time.
- Encourages greater participation in employer-subsidized long-term care insurance plans by employees.
  - Employer-subsidized long-term care insurance plans generally see greater participation rates by employees.
  - Employee participation in employer-sponsored long-term care insurance plans is significantly greater when the employer pays for a small percentage, or "base coverage," of the employee's premium.

## **II. TECHNICAL ISSUES**

The Department notes that the current drafting of the bill appears to apply at the entity level for partnerships and other flow-through business entities. The Department suggests that any reference to the credit claim for partnerships or limited liability companies clearly distinguish that the credit is determined at the entity level. The Department further points out that partnerships and limited liability companies treated as partnerships for tax purposes typically never receive tax treatment—*it is the owners that receive all incidences of taxation*. Under the current drafting of the bill, a statement providing that for partnerships or other flow-through entities the credit is determined at the entity level, this will allow the credit to be distributed to partners in proportion to their partnership interests.

The following language would be helpful:

"( ) In the case of a partnership, S corporation, estate, or trust, the tax credit allowable shall be determined at the entity level. Distribution and share of credit shall be determined in accordance with section 235-2.45(d)."

### **III. SUGGESTED BILL LANGUAGE**

As an alternative to the text of the current bill, the Department offers the following tax credit language for the Committee's consideration:

**"§235- Employer's tax credit for long-term care premiums paid for employees.** (a) Subject to the limitations of this section, a small business employer subject to taxation under this chapter may claim a non-refundable tax credit for premium payments made by the small business employer during the taxable year to purchase a qualified long-term care insurance contract for its employees. The maximum tax credit per employee for whom qualified long-term care insurance is purchased shall be in the amount of the lesser:

- (1) \$500; or
- (2) Fifty per cent of the qualified long-term care premiums paid annually for each employee.

(b) The credit allowed under this section shall be claimed against the net income tax liability for the taxable year. If the tax credit under this section exceeds the taxpayer's income tax liability, the excess of the credit may be carried forward until exhausted.

(c) If a taxpayer claims any other tax credit or deduction under title 14, including a deduction under sections 162 or 213 of the Internal Revenue Code, to which state law conforms, for premiums paid on a long-term care insurance policy, no credit shall be claimed under this section for the same premium payments.

(d) All claims, including any amended claims, for tax credits under this section shall be filed on or before the end of the twelfth month following the close of the taxable year for which the credit may be claimed. Failure to comply with this provision shall constitute a waiver of the right to claim the credit.

(e) The director of taxation shall prepare any forms that may be necessary to claim a credit under this section. The director may also require the taxpayer to furnish information to ascertain the validity of the claims for deductions made under this section and may adopt rules necessary to effectuate the purposes of this section pursuant to chapter 91.

- (f) As used in this section:

"Activities of daily living" means eating, toileting, transferring, bathing, dressing, and continence.

"Chronically ill individual" means any individual who has been certified by a licensed healthcare practitioner within the preceding twelve-month period as meeting one of the following conditions:

- (1) Being unable to perform at least two activities of daily living without substantial assistance from another individual for a period of at least ninety days due to a loss of functional capacity;
- (2) Having a level of disability similar to the disability set forth in the preceding paragraph; or
- (3) Requiring substantial supervision to protect that individual from threats to health and safety due to a severe cognitive impairment for the preceding twelve-month period.

"Home and community-based care" means care provided under qualified long-term care services that meet or exceed the requirements set forth in section 431:10H-219.

"Licensed health care practitioner" means any licensed physician, registered nurse, licensed social worker, or other professional as may be provided by rules adopted by the director of taxation.

"Maintenance or personal care services" means any care the primary purpose of which is the provision of needed assistance with any of the disabilities that render a person to be a chronically ill individual, including the protection from threats to health and safety due to a severe cognitive impairment.

"Qualified long-term care insurance contract" means a contract that:

- (1) Provides insurance coverage solely for qualified long-term care services;
- (2) Does not pay or reimburse expenses incurred for services or items to the extent that those expenses are reimbursable under title XVIII of the Social Security Act or would be so reimbursable but for the application of a deductible or coinsurance amount, unless:
  - (A) The expenses are reimbursable by medicaid as secondary payor; or
  - (B) The contract makes qualified per diem or other periodic payments without regard to expenses, as defined below.
- (3) Is guaranteed renewable;
- (4) Provides that refunds, other than refunds on the death of the insured or complete surrender or cancellation of the contract, and dividends under the contract shall be used only to reduce future premiums or increase future benefits;

(5) Does not provide for a cash surrender value or any other money that may be paid, assigned, borrowed, or pledged as collateral for a loan; and

UU(6) Provides coverage for home- and community-based care services that meets or exceeds fifty per cent of the coverage for treatment in an intermediate care facility and skilled nursing facility.

"Qualified long-term care services" means necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, and maintenance or personal care services, which are:

(1) Required by a chronically ill individual; and

(2) Provided pursuant to a plan of care prescribed by a licensed health care practitioner.

"Small business" means a for-profit enterprise consisting of fewer than one hundred full-time or part-time employees."

#### **IV. REVENUE IMPACT**

Assuming this measure takes effect immediately, annual revenue loss amounts to \$900,000 for FY 2010 and thereafter. Based on the best estimate from the long-term care industry, employers pay \$5 to \$15 per employee per month for long-term care premium. Their employers cover about 50,000 of the employee's long-term care insurance.

Employers are assumed to pay \$120 per employee annually for long-term care premium. A tax credit at 50% of premiums is \$60.

According to the Hawaii State Data Book 2006, all businesses employed 490,682 workers in 2005 and 59% of which were employed by small businesses. The Department assumed employers purchased long-term care insurance for 50% of small business employment share (30%). About 15,000 employees' long-term care insurance was covered by their employers [50,000 x 30%]. Total tax credit amounted to \$900,000 [15,000 x \$60].

TESTIMONY OF THE AMERICAN COUNCIL OF LIFE INSURERS  
IN SUPPORT OF H. B. 2778, HD 2, SD 1, RELATING TO TAX CREDITS

March 18, 2008

Senator Carol Fukunaga, Chair  
Committee on Economic Development and Taxation  
State Senate  
Hawaii State Capital, Conference Room 016  
415 S. Beretania Street  
Honolulu, HI 96813

Dear Chair Fukunaga and Committee Members:

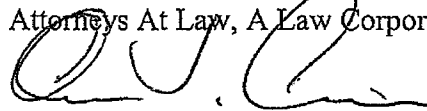
Thank you for the opportunity to testify in support of House Bill 2778, HD 2, SD 1, relating to taxation.

Our firm represents the American Council of Life Insurers ("ACLI"), a national trade association whose three hundred fifty-three (353) member companies account for 93% of the life insurance premiums and 94% of the annuity considerations in the United States among legal reserve life insurance companies. ACLI member company assets account for 93% of legal reserve company total assets. Two hundred sixty-one (261) ACLI member companies currently do business in the State of Hawaii.

ACLI supports House Bill 2778, HD 2, SD 1, which provides an income tax credit to a qualified resident individual or a corporate "small business" employer (defined as having less than 100 employees) in an amount equal to the lesser of \$500 or 50% of the cost of the long-term care insurance premium for each employee.

ACLI generally believes that as a matter of public policy the State of Hawaii should encourage individuals to provide for their own financial well-being. If a family is unable to support its long-term care needs, the State will need to spend its scarce resources for that purpose.

CHAR HAMILTON  
CAMPBELL & YOSHIDA  
Attorneys At Law, A Law Corporation



Oren T. Chikamoto  
737 Bishop Street, Suite 2100  
Honolulu, Hawaii 96813  
Telephone: (808) 524-3800  
Facsimile: (808) 523-1714



Laura Manis Testifier

---

COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

Senator Carol Fukunaga, Chair

Senator Will Espero, Vice Chair

Tuesday, March 18, 2008, 1:15 p.m. Conference Room 224

**HB 2778, HD2** RELATING TO TAX CREDITS. Grants tax credit to small businesses at the lesser of 50% of premiums or \$500 per employee for purchase of long-term care insurance for its employees. Defines small business as businesses employing less than 100 full-time or part-time workers.

**SUPPORT WITH COMMENTS**

Kokua Council realizes that this is a new perspective to providing an incentive for buying Long Term Care Insurance. Providing a tax credit to employers of small businesses who purchase the insurance for their employees is worth a trial.

**For this reason we suggest that a sunset date be included in the bill to give time to evaluate whether or not it did indeed increase the purchase of Long Term Care Insurance. Also of concern, is who pays for the insurance if the employee changes jobs.**

Laura G. Manis, Legislative Chair, Kokua Council  
tel. 597-8838

Senate Committee on Economic Development & Taxation  
Senator Carol Fukunaga, Chair

**Date of Hearing: March 18, 2008**  
**Time: 1:15 PM**

**RE: HB 2778, HD 2, SD 1 – Relating to Tax Credits**

Chair Fukunaga and members of the Committee, NAIFA (National Association of Insurance and Financial Advisors) Hawaii, an organization made up of insurance and financial advisors across Hawaii **supports HB 2778, HD 2, SD 1**, in providing Hawaii employers with fewer than 100 full or part time employees and small business owners with an incentive to purchase LTC (long term care) insurance.

The tax credit proposed will be the lesser of \$500 for each employee or 50% of the insurance premium for each employee. Employers will be able to insure employees at a base level and in turn, the employees will be able to purchase added coverage. We believe that this incentive is integral to get the “ball rolling” and the bulk of the LTC premium will be borne by employees.

Employers, if they are paying LTC premiums as a benefit to their employees, can also deduct the entire LTC insurance premium expense on their corporate tax return. This measure can provide a very worthwhile incentive to employers to encourage them to make this benefit available since most employee benefits (health insurance, TDI, disability income, retirement, Social Security, Medicare, etc.) are delivered at the workplace. Employers can provide one of the best venues in educating our citizens about their future LTC needs.

Additionally, there are numerous benefits for a group purchase of LTC insurance:

- Group LTC insurance policies are approximately 10% to 40% less than individual LTC policies subject to underwriting requirements (age, health, etc.).
- Premiums are level, based on age purchased, which encourages younger employees to participate. Employees receive guaranteed issue coverage (no medical questions) up to certain limits.
- Employees can customize the coverage beyond the employer paid base plan, at highly discounted rates. Employees can add to their coverage at anytime.
- Employee’s **entire extended family** (parents, grandparents, in-laws, siblings, adult children) can participate in the discounted group rates.



Page 2 of NAIFA Hawaii Testimony

- Employees can take their coverage with them should they retire or terminate their employment at same rate with the exact same coverage and extended family members retain their coverage.
- Premiums are level, based on age purchased, which encourages younger employees to participate. Employees receive guaranteed issue coverage (no medical questions) up to certain limits.

Government's support of a tax incentive in encouraging individual responsibility for long term care financing is a step towards solving this complex issue. Our citizens will have these products to protect themselves against catastrophic long term care expenses. The expansion of this market will reduce Medicaid outlays and future costs to both the federal and state governments.

Yes, it is true that the older one gets, a LTC insurance policy becomes less affordable due to chronic ailments or unavailable due to sickness. A tax credit for employers and individuals will encourage the young to purchase their LTC insurance when they are healthy and rates are most affordable.

Medicaid began as a safety net for the less fortunate but over the past 30 years it has become a way for many families to keep their assets. The term "spending down" is well understood in qualifying for Medicaid. We believe that through the purchase of long term care insurance from the marketplace, we can save Medicaid for what it was truly intended. The burden on the state and federal government is enormous and continues to grow.

We urge your support for this measure. Mahalo for allowing us to share our viewpoint.

Cynthia Hayakawa  
Executive Director





**The Chamber of  
Commerce of Hawaii**

*Since 1850*

**Testimony to the Senate Committee on Economic Development and Taxation  
Hawaii State Capitol  
Conference Room 224  
415 South Beretania Street  
Tuesday, March 18, 2008 at 1:15 p.m.**

**SUBJECT: HOUSE BILL 2778, HD2, SD1 - RELATING TO TAX CREDITS**

Chair Fukunaga, Vice Chair Espero, and Members of the Committee:

My name is Jim Tollefson and I am the President and CEO of The Chamber of Commerce of Hawaii ("The Chamber"). I appreciate the opportunity to state The Chamber's support of HB 2778, HD2, SD1, relating to Tax Credits.

The Chamber is the largest business organization in Hawaii, representing over 1100 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

The measure grants tax credits to small businesses at the lesser of fifty per cent of premiums or \$500 per employee for the purchase of long-term care insurance for its employees. The measure defines small business as businesses employing less than 100 full-time or part-time workers.

The Chamber commends the Legislature for seeking ways to address the current situation of long-term care for Hawaii's senior and adult disabled population and supports a statewide effort to address this growing population through various voluntary initiatives such as tax credit incentives, especially for small businesses.

Small employers provide a majority of the jobs in Hawaii. As the cost of doing business continues to rise and the economy begins to slow down, small businesses will be forced to make prudent and sound decisions on providing benefits to employees while managing costs. However, many recognize the current and growing problem of long-term care and realize that in order to retain quality employees, they will need to offer benefits. This measure provides an option and incentive for small businesses to offer benefits such as long-term care insurance for their employees.

In light of this, The Chamber asks for your favorable consideration of this measure. Thank you for the opportunity to testify.

# TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

**SUBJECT:** INCOME, Small business long-term care insurance premium tax credit

**BILL NUMBER:** HB 2778, SD-1

**INTRODUCED BY:** Senate Committee on Human Services and Public Housing

**BRIEF SUMMARY:** Adds a new section to HRS chapter 235 to allow taxpayers who own a small business to claim a small business long-term insurance premium credit of the lesser of \$500 per employee or 50% of the premiums paid for each employee. Credits in excess of a taxpayer's income tax liability may be applied to subsequent liability. Defines "small business" as a for-profit enterprise consisting of fewer than one hundred full-time or part-time employees.

Stipulates that the tax credit when claimed by: (1) either an individual resident taxpayer or a husband and wife filing a joint return that own a small business, provided that a resident husband and wife filing separate tax returns for a taxable year for which a joint return could have been filed by them, shall claim only the tax credit to which they would have been entitled under this section had a joint return been filed; or (2) a small business that is a corporation, partnership, limited liability company, or other form of business entity, may be claimed only once in the taxable year with respect to the small business.

Claims for the credit must be filed within twelve months of the close of the taxable year or be waived if not filed on time. Requires the director of taxation to prepare the necessary forms to claim and validate a claim for the credit.

**EFFECTIVE DATE:** July 1, 2008; applicable to tax years beginning after December 31, 2008

**STAFF COMMENTS:** This measure provides an incentive in the form of an income tax credit to encourage employers to purchase long-term care insurance premiums for their employees by allowing the employer to claim a credit for a portion of the premium costs for such insurance. While the credit may seem minimal, buying a group coverage for the minimal level of coverage would open the door of awareness for more employees of the need for this type of care in the future. Accessing this type of insurance will not only increase awareness of this need, but may allow employees to trade up by paying an additional premium, then this may be a way that the state addresses the challenge of long-term care.

That said, one has to question whether or not taxpayers should subsidize the cost of such insurance without any indication of need on behalf of the small business for financial assistance. Perhaps the sponsors of the bill envision that this would encourage mom and pop stores to secure this coverage or perhaps a lunch wagon owner. However, the bill defines a small business as one that has less than 100 full-time employees. That definition could fit a brokerage firm, a software developer, or a private physician's office. If the intent is to make the public aware of the need to secure this type of insurance, then there are means for informing and educating the public. One of the chief reasons for consumer reticence in this area is the fear of the unknown, that is not knowing anything about the options from which they can choose.

Digested 3/17/08