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**HOUSE COMMITTEE ON FINANCE
TESTIMONY REGARDING HB 2778 PROPOSED HD 2
RELATING TO TAX CREDITS**

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 26, 2008
TIME: 10:00AM
ROOM: 308

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 Department of Taxation (Department) **supports the intent** of 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.

III. REVENUE IMPACT

Annual revenue loss amounts to \$900,000.

L E G I S L A T I V E

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Honolulu, Hawaii 96813 Tel. 536-4587

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

BILL NUMBER: HB 2778, Proposed HD-2

INTRODUCED BY: *FIN 2/26*
House Committee on Finance

BRIEF SUMMARY: Adds a new section to IIRS 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: Tax years beginning after December 31, 2006

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 2/25/08

House Finance Committee
Representative Marcus Oshiro, Chair

Date of Hearing: Tuesday, February 26, 2008
Time: 10 am – Agenda # 1A

RE: HB 2778, HD1 – Proposed HD2 -- Comments ONLY

Chair Oshiro and members of the Committee, my name is Cynthia Hayakawa, Executive Director of NAIIFA (National Association of Insurance and Financial Advisors) Hawaii, an organization made up of insurance and financial advisors across Hawaii.

We support the Proposed HD2 of HB 2778, HD1, 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.

We ask that the effective date be amended to read, "...shall apply to taxable years beginning after December 31, **2008**." The Proposed HD2 says December 31, 2006.

The tax credit allowed will be the lesser of \$500 for each employee or 50% of the insurance premium for each employee. **We suggest that the tax credit be reduced substantially** from \$500 per employee (\$41.67/month) so that the tax loss will be less. This will afford the employer to insure every employee at a base level and in turn, the employees will be able to purchase added coverage.

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 could provide one of the best venues in educating our citizens about their future LTC needs.

This credit will afford the employer to insure every employee at a base level and in turn, the employees will be able to purchase added coverage. We believe that this kind of incentive is integral to get the "ball rolling" and the bulk of the LTC premium will be borne by employees.

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.
- 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.
- 40% of employees will purchase additional discounted coverage out of their own pocket.

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. Thank you for allowing us to share our viewpoint.



TESTIMONY OF THE AMERICAN COUNCIL OF LIFE INSURERS
IN SUPPORT OF H. B. 2778, PROPOSED HD2, RELATING TO TAX CREDITS

February 26, 2008

Representative Marcus R. Oshiro, Chair
Committee on Finance
State House of Representatives
Hawaii State Capital, Conference Room 308
415 S. Beretania Street
Honolulu, HI 96813

Dear Chair Oshiro and Committee Members:

Thank you for the opportunity to testify in support of House Bill 2778, Proposed HD 2, relating to tax credits.

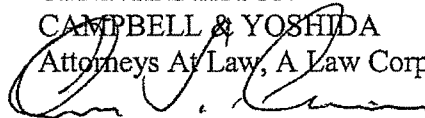
Our firm represents the American Council of Life Insurers ("ACLI"), a national trade association whose three hundred fifty-three (353) member companies account for 93% of the life insurance premiums and 94% of the annuity considerations in the United States among legal reserve life insurance companies. 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, Proposed HD 2, which provides an income tax credit to small business employers (having less than 100 employees) regardless of their adjusted gross income, in an amount equal to the lesser of \$500 for each employee 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 families 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.

Again, thank you for the opportunity to testify in support of House Bill 2778, Proposed HD 2.

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