2315

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

TWENTY-FOURTH LEGISLATURE
Regular Session of 2008

Thursday, January 31, 2008
9:00 a.m.

TESTIMONY ON SENATE BILL NO. 2315 – 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.

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.

HAWAII MEDICAL ASSOCIATION 1856

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January 30, 2008

2315

Comm.
1-31-08, Th
9:00 am
Conf. Rm.229

To: Senator Russell S. Kokubun, Chair
Senator David Y. Ige, Vice Chair
Senate Committee on Consumer Protection and Commerce

From: Cynthia Goto, M.D., President
Linda Rasmussen, M.D., Legislative Co-Chair
Philip Hellreich, M.D., Legislative Co-Chair
Dick Botti, Government Liaison

RE: SB2315 Relating to Insurance (Provides that a reciprocal insurer and its attorney-in-fact are considered a single entity for general excise tax purposes)

The Hawaii Medical Association (HMA) supports SB2315.

The purpose of this bill is to correct a misinterpretation of law resulting in double taxation and unfair treatment of reciprocal insurers and their attorneys-in-fact, who unlike their incorporated stock or mutual insurer counterparts, are not exempt from the general excise tax.

SB2315 corrects this misinterpretation by recognizing a reciprocal insurer and its attorney-in-fact as a single entity that is not subject to double taxation under Hawaii law.

The HMA has taken a position on this bill because medical malpractice insurers have been made subject to double taxation.

The added cost of the double taxation will be passed on to Hawaii's physicians in the form of higher premiums, which will exacerbate Hawaii's patient access to care crisis.

Already high medical malpractice insurance premiums have been a major causation of Hawaii's physician shortage. Physicians are moving away from Hawaii, retiring early and/or have stopped offering high-risk, but life-saving treatment and procedures, due to liability concerns.

While approval of this bill does not replace the passage of meaningful medical liability reform, we ask that this committee approve this bill to avoid exacerbating this crisis.

The HMA supports meaningful medical liability reform consisting of

- A cap of $250,000 on non-economic damages (ie. pain and suffering, loss of consortium, loss of enjoyment of life);

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- NO limits on economic damages (ie. past and future medical expenses, cost of living expenses, lost wages, etc.);

- NO limits on punitive damages (intended to punish the defendant for negligent and/or reckless behavior); and
- Changing joint and several liability law to make damages proportion to each defendant's share of responsibility.

These measures of meaningful medical liability reform have served as a powerful physician recruiting and retention tool for other states. Texas, in particular, has compelling data showing vast improvements in patient access to care since passing medical liability reform in 2003.

Given Hawaii's remote location, high cost of living and other disadvantages, medical liability reform is necessary for Hawaii to compete for its physician workforce.

Thank you for the opportunity to testify on this matter.

TESTIMONY ON S.B. NO. 2315
RELATING TO INSURANCE

SENATE COMMITTEE ON COMMERCE,
CONSUMER PROTECTION AND AFFORDABLE HOUSING
Sen. Russell S. Kokubun, Chair
Sen. David Y. Ige, Vice Chair

Thursday, January 31, 2008, 9:00 a.m.
State Capitol, Conference Room 229

My name is Donna K. Ikegami. I am testifying on behalf of Medical Insurance Exchange of California ("MIEC") and Medical Underwriters of California ("MUC").

By way of background, MIEC is a California reciprocal insurer formed 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 ("reciprocal") and its attorney-in-fact as a single entity that is not subject to double taxation under Hawaii law.

MIEC strongly supports this bill, but would like to recommend several amendments to ensure that each attorney-in-fact of a reciprocal will be subject to all taxes imposed upon corporations or others doing business in Hawaii, other than taxes on income or gross proceeds derived from its principal business as attorney-in-fact. Our proposed amendments are set forth in the attached material.

A reciprocal is recognized by chapter 431, Hawaii Revised Statutes ("HRS") (the Insurance Code), as an insurance company or insurer that provides insurance through unincorporated associations of individuals, partnerships, or corporations called "subscribers." The reciprocal is directly owned by its policyholders.

In the case of a stock or mutual insurer, which is required by law to be formed as a corporation, the corporation's officers and employees are responsible for managing and operating the stock or mutual insurer. The reciprocal is an unincorporated association of subscribers that operates through what is called an "attorney-in-fact" common to all of its subscribers. As a result, the reciprocal and attorney-in-fact are virtually indistinguishable.

Insurers in Hawaii are taxed in lieu of most state taxes because they are subject to the insurance premium tax under HRS §431:7-204. HRS §237-29.7 exempts "insurance companies authorized to do

business under chapter 431" from paying the general excise tax, as long as the insurance company has paid the insurance premium tax.

The Hawaii Insurance Division has long recognized a reciprocal and its attorney-in-fact as a single entity for regulatory purposes. However, since the term "insurance company" is not defined in chapter 237, HRS, or the Insurance Code, the law has been interpreted not to apply a reciprocal and its attorney-in-fact.

As a result, notwithstanding that 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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PROPOSED AMENDMENTS TO S.B. NO. 2315

W/HOUSE

1. Page 4, line 3: Delete "for tax purposes";

2. Page 4, lines 5-7: Delete paragraph (1) and insert the following:

"(1) Ensures that when a reciprocal insurer is conducting the business of insurance in Hawaii through its attorney-in-fact, the reciprocal insurer and its attorney-in-fact shall be considered a single entity that qualifies for the general excise tax exemption under section 237-29.7, Hawaii Revised Statutes;"

3. Page 5, lines 6-7: Delete the entire sentence: "For purposes of this section, a reciprocal insurer and its attorney-in-fact shall be considered singularly as an insurer."

4. Page 5, line 20: Insert a new SECTION 5 to read as follows:

"SECTION 5. Section 431:7-204, Hawaii Revised Statutes, is amended to read as follows:

"**§431:7-204 In lieu provision.** (a) As to insurers, the taxes and fees imposed by section 431:7-201 to section 431:7-204, and the fees imposed by this code, when paid shall be in settlement of and in lieu of all demands for taxes, licenses, or fees of every character imposed by the laws of this State, the ordinances or other laws, rules, or regulations of any county of this State, except:

(1) As expressly otherwise provided;
(2) Taxes on real property;
(3) Taxes on the purchase, use, or ownership of tangible personal property; [~~and~~]
(4) Taxes on gross income, gross proceeds, gross rental, or gross rental proceeds under chapter 237 or 237D[~~,~~]; and
(5) Each corporate or other attorney-in-fact of a reciprocal insurer shall be subject to all taxes imposed upon corporations or others doing business in the state, other than taxes on income or gross receipts derived from its principal business as attorney-in-fact.

Nothing in this section shall be deemed to exempt insurers from liability for withholding taxes payable by their employees and paying the same to the proper collection officers, or from keeping such records, and making such returns and reports, as may be required in the case of other persons enjoying tax exemption.

(b) As used in this section, "attorney-in-fact" means the attorney-in-fact authorized to act for an unincorporated aggregation of subscribers of a reciprocal insurer as a whole and not for the benefit of an individual subscriber or group of subscribers less than the entire membership of the reciprocal insurer pursuant to section 431:3-108. For the purpose of this section, a reciprocal insurer and its attorney-in-fact shall be considered a single entity."

5. Page 5, line 20: Renumber Ramseyer Format Statement Section as SECTION 6.

6. Page 6, line 1: Renumber Effective Date Section as SECTION 7.

L E G I S L A T I V E

10-11

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

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 a 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 as 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 an 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