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

HOUSE COMMITTEE ON CONSUMER PROTECTION & COMMERCE

TESTIMONY REGARDING SB 2315 SD 2
RELATING TO INSURANCE

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 10, 2008
TIME: 2:00PM
ROOM: 325

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

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

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

STATE OF HAWAII
OFFICE OF THE DIRECTOR
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
335 MERCHANT STREET, ROOM 310
P.O. Box 541
HONOLULU, HAWAII 96809
Phone Number: (808) 586-2850
Fax Number: (808) 586-2856
www.hawaii.gov/dcca

LAWRENCE M. REIFURTH
DIRECTOR

RONALD BOYER
DEPUTY DIRECTOR

TO THE HOUSE COMMITTEE ON
CONSUMER PROTECTION & COMMERCE

TWENTY-FOURTH LEGISLATURE
Regular Session of 2008

Monday, March 10, 2008
2:00 p.m.

TESTIMONY ON SENATE BILL NO. 2315, S.D. 2 – RELATING TO INSURANCE.

TO THE HONORABLE ROBERT HERKES, 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 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) HRS § 431:7-204 by adding a definition of "attorney-in-fact" and clarifying that the attorney-in-fact of a reciprocal insurer is exempt from taxes on income derived from its principal business as attorney-in-fact.

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 GET 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.

TESTIMONY ON S.B. NO. 2315, S.D. 2
RELATING TO INSURANCE

HOUSE COMMITTEE ON CONSUMER PROTECTION & COMMERCE
Rep. Robert N. Herkes, Chair
Rep. Angus L.K. McKelvey, Vice Chair

Monday, March 10, 2008, 2:00 p.m.
State Capitol, Conference Room 325

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.

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:

Gerald C. Yoshida
Char Hamilton Campbell & Yoshida
737 Bishop Street, Suite 2100
Honolulu, Hawai`i 96813
Ph: 524-3800

Please deliver to:
House CPC
Comm.
3-10-2008,
Monday
2:00pm
Conf. Rm.325

March 10, 2008

To: Rep. Robert Herkes, Chair
Rep. Angus McKelvey, Vice Chair
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 SD2 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 SD2.

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 SD2 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

Hawaii Medical Association
1360 S. Beretania St.
Suite 200
Honolulu, HI 96814
(808) 536-7702
(808) 528-2376 fax
www.hmaonline.net

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