

# HB798, HD1

**Measure Title:** RELATING TO TAXATION.

**Report Title:** General Excise Tax; Life Settlement Contract

**Description:** Imposes the general excise tax on the gross income derived from a life settlement contract. Effective July 1, 2011. (HB798 HD1)

**Companion:**

**Package:** None

**Current Referral:** CPN, WAM

NEIL ABERCROMBIE  
GOVERNOR

BRIAN SCHATZ  
LT. GOVERNOR



STATE OF HAWAII  
**DEPARTMENT OF TAXATION**  
P.O. BOX 259  
HONOLULU, HAWAII 96809  
PHONE NO: (808) 587-1530  
FAX NO: (808) 587-1584

FREDERICK D. PABLO  
DIRECTOR OF TAXATION

RANDOLF L. M. BALDEMOR  
DEPUTY DIRECTOR

## SENATE COMMITTEE ON COMMERC AND CONSUMER PROTECTION

### TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING HB 798 HD 1 RELATING TO TAXATION

**TESTIFIER:** FREDERICK D. PABLO, DIRECTOR OF TAXATION (OR  
DESIGNEE)  
**COMMITTEE:** FIN  
**DATE:** MARCH 15, 2011  
**TIME:** 9:00AM  
**POSITION:** SUPPORT

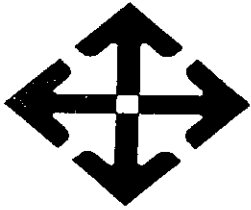
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This measure assesses the general excise tax (GET) on certain life settlement contract proceeds paid to persons that are not related to the insured.

The Department supports this measure because it taxes business receipts that should be taxable under a gross receipts tax. Under a gross receipts system of taxation, all receipts are taxed uniformly. Exemptions should be limited. Currently, life settlement contract payouts are exempt from the GET, which erodes the GET tax base. Taxing life settlement contract amounts for GET purposes is sound tax policy because these amounts are, after all, business receipts to the extent received by persons engaged in business. Thus, the Department supports amending the GET law to tax life settlement contract payouts and sales to persons not related to the insured who are in the business of dealing in these types of life settlement contracts or otherwise engaged in business.

**REVENUE GAIN**—This measure will result in revenue gain as follows:

- FY2012, \$45,000;
- FY2013, \$90,000;
- FY2014, \$135,000,
- FY2015, \$180,000; and
- FY2016, \$225,000.



# The Hawaii Business League

Century Square 1188 Bishop St., Ste 1003 Honolulu, HI 96813-3304  
Phone: (808) 533-6819 ♦ Facsimile: (808) 533-2739

March 15, 2011

Testimony To: Senate Committee on Commerce and Consumer Protection  
Senator Rosalyn H. Baker, Chair

Presented By: Tim Lyons  
President

Subject: H.B. 798, HD 1 – Relating to Taxation

Chair Baker and Members of the Committee:

I am Tim Lyons, President of the Hawaii Business League, a small business service organization. We are opposed to this bill.

It is typical that many small businesses in Hawaii will use Key Man Insurance in order to protect themselves from losses as a result of a loss of a key employee. This kind of insurance is essential and necessary particularly for small corporations who need to have some sort of influx of resources in order to recoup from the loss of a key employee.

We realize that the state is hunting for cash wherever they can find it however, we believe it is essential to recognize that insurance proceeds at the time of a loss only assists partially in trying to recover from that loss both emotionally and financially. The imposition of the general excise tax on

these proceeds, we believe, is going to put the State in a position of unfavorable consideration by the parties. The fact that the State would take this opportunity to extract some money out of a settlement is in our mind, unwarranted and difficult to justify.

Based on the above, we cannot concur with this bill and do not recommend its support.

Thank you.

# TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Taxation of certain insurance death benefits

BILL NUMBER: HB 798, HD-1

INTRODUCED BY: House Committee on Finance

BRIEF SUMMARY: Adds a new section to HRS chapter 237 to provide for the imposition of the general excise tax on the gross income derived from a life settlement contract by a person unrelated to the insured. The tax shall not be imposed on: (1) any compensation received by the insured of a life insurance policy for the transfer of the policy to another person or designation of a beneficiary; or (2) any death benefit paid under a life insurance policy upon the death of the insured to a person related to the insured.

Defines "gross income derived from a life settlement contract" as: (1) the value of the death or other benefit paid upon the passing of the insured to a person unrelated to the insured under a life settlement contract; and (2) any compensation received by a person, other than the insured, from the transfer of a life settlement contract to another person.

Defines "life settlement contract" and delineates what shall not be considered to be a life settlement contract. Also defines "owner," "provider" and "transfer" for purposes of the measure.

Makes conforming amendments to HRS section 237-24. Amendments made by this act to HRS section 237-24 shall not be repealed when that section is repealed and reenacted on December 31, 2013 pursuant to Act 70, SLH 2009.

EFFECTIVE DATE: July 1, 2011

STAFF COMMENTS: Under the current law, death benefits are not subject to the 4% general excise tax. While this measure would subject the death benefits or other gross income derived by a recipient of a life settlement contract to the 4% general excise tax, it appears that this measure is merely proposed to generate funds to address the dire financial condition of the state at the expense of selected taxpayers.

This measure seems to focus on insurance benefits paid on a life settlement to a person unrelated to the insured as opposed to insurance death benefits paid to a next of kin. It should be remembered that the general excise tax is imposed on the gross income of a taxpayer for the privilege of doing business in the state. One then has to ask what privilege of doing business does an insurance death benefit represent? Were goods or services sold to produce the death benefit? If anything, the service that was sold was the promise to pay a death benefit represented by the insurance premium. While insurance premiums are not subject to the state general excise tax, they are subject to the in-lieu insurance premiums tax.

This proposal to impose the general excise tax on the proceeds of a life insurance policy clearly underscores the lack of understanding of the general excise tax. The adoption of this proposal would

raise questions as to the basis of the gross receipts tax. That basis is that the tax is imposed for the privilege of doing business in the state. The subject life insurance contracts where the proceeds are paid out to an unrelated person should be no different than that paid to a related person. The value of these types of life insurance settlement contracts is to make whole the beneficiary of the life settlement contract for the services or presence of the insured until such time that the beneficiary can be made whole. No goods or services are exchanged for the amount received from a life settlement, thus, there is no privilege granted for conducting business in this state. Given the fact that a life insurance policy does not represent business income earned, it is not an erosion of the tax base which is supposed to be the proceeds of having produced goods or delivered services. What goods or services sold does the life insurance settlement represent?

The life insurance settlement is not the same thing as business interruption insurance which is secured to replace the gross proceeds of a business that could not conduct business for the named reasons such as a natural disaster, a power outage, or other unforeseen circumstances that prohibit the business from opening its doors. That type of insurance, which represents the replacement of gross income that would otherwise have been earned for the privilege of doing business, is subject to the general excise tax just as much as the gross income received from that business' sale of goods or services would have been subject to the general excise tax had there been no interruption of business.

If this measure is enacted, it could also result in the taxation of life settlements to an unrelated third party in the case of a bequest of an insured who has designated a charitable organization as a recipient of the life settlement who will then be subject to the general excise tax on such proceeds. As proposed, it is questionable whether this is the intent of the proposed measure. Apparently lawmakers avoided trying to levy the general excise tax on benefits that go to a relative of the deceased but overlooked the situation where such proceeds are intended to benefit a charity. This underscores the need to exercise care in attempting to turn another stone to find additional revenues without exploring the consequences of such an action.

Because this measure opens such a can a worms and raises questions about the underlying philosophy of the general excise tax, one has to ask whether or not all of the uncertainty it raises is worth the revenues it is supposed to generate. It is doubtful that, as redrafted in this form, there is much to gain for all of the angst it will generate. If adopted, this measure would set a bad precedent that runs counter to the underlying philosophy of the general excise tax.

Digested 3/14/11