

HB 798

HD 1, SD1

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SUBJECT: GENERAL EXCISE, Taxation of certain insurance death benefits

BILL NUMBER: HB 798, SD-1

INTRODUCED BY: Senate Committee on Commerce and Consumer Protection

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 Amendments made by this act to HRS section 237-24 shall not be repealed when that section is repealed and reenacted on December 31, 2013 pursuant to Act 70, SLH 2009.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

It should be noted that when new material is added to the law, it is underscored to show that it is new language. Since the language in section 2 of this measure is new material, the whole section should be underscored. As drafted, there is underscoring missing. Also Standing Committee Report 827 stated that the Committee on Commerce and Consumer Protection inserted an effective date of July 1, 2050. However, the actual SD-1 has an effective date of July 1, 2011.

Digested 3/29/11