

KFH483  
A85  
183  
1977  
c. 2

**A STUDY OF HAWAII'S  
GENERAL EXCISE TAX ON COMMISSIONS**

**By**

**LESTER ISHADO  
Researcher**

LEGISLATIVE REFERENCE BUREAU  
JAN 10 1978  
STATE OF HAWAII

**Request No. 0578-A  
December 1977**

**Legislative Reference Bureau  
State of Hawaii**

## FOREWORD

This study on the applicability of the excise tax to various occupations operating on commissions, including insurance solicitors, general agents, and subagents, was prepared in response to Senate Resolution No. 456, S.D. 1, of the Ninth Legislature of the State of Hawaii, Regular Session of 1977.

Information and comments received from the Department of Taxation, Department of Regulatory Agencies, Mr. Mitsuru Fujimoto, Mr. Harry Albright, and SIDA of Hawaii, Inc. are gratefully acknowledged and sincerely appreciated.

Samuel B. K. Chang  
Director

December 1977

## TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION.....	1
II. APPLICABILITY OF THE EXCISE TAX TO COMMISSIONS.....	2
Problem Facing Insurance Agents.....	2
Listing of Other Occupations.....	4
Occupations Which Can Not Pass On Tax and Reasons Therefor.....	6
Actual Tax Burden.....	7
Revenue Impact.....	8
Summary of Other States' Treatment.....	8
III. FINDINGS AND RECOMMENDATIONS.....	11
Summary.....	11
Alternatives.....	12
Alternative I: Maintaining the Present Law.....	13
Alternative II: Arguments in Favor of Some Change in Present Law.....	13
Alternative IIA: Adjustment of Insurance Premium Rate.....	15
Alternative IIB: Excise Tax Exemption.....	16
Alternative IIC: Reduction in Rates.....	16
Caveat: Finding Other Revenue Sources.....	17
Recommendation I: Allow Agents to Pass on Tax.....	18
Implementation .....	19
Alternative Recommendation: Reduce Tax Rates.....	21
Other Recommendations.....	22
Implementation .....	23
Consideration of Affected Parties and Agency Responses to Study.....	24
FOOTNOTES.....	30

## APPENDICES

A. S.R. No. 456, S.D. 1, Ninth Legislature, 1977, State of Hawaii.....	33
B. Hawaii Revised Statutes (Sec. 431-424); Revised Ordinances of the City and County of Honolulu (Sec. 12-1.9); United States Code (Sec. 1373); letter from Air Transport Association of America to Lester J. Ishado of the Legislative Reference Bureau; and letter from the City and County to Samuel B. K. Chang, Director, Legislative Reference Bureau, regarding taxicab fares.....	35

	<u>Page</u>
C. Letter and listing from the Department of Taxation to Samuel B. K. Chang, Director, of the Legislative Reference Bureau and letter from the Department of Regulatory Agencies to Lester Ishado, Researcher, Legislative Reference Bureau.....	42
D. Affected Parties and Agency Responses to Study.....	48

## Chapter I

### INTRODUCTION

Senate Resolution No. 456, S.D. 1,<sup>1</sup> adopted by the Senate at the Regular Session of 1977, requests the Office of the Legislative Reference Bureau, with the cooperation and assistance of the Department of Taxation and the Department of Regulatory Agencies, to conduct a study on the applicability of the general excise tax to insurance solicitors, general agents, and subagents, to determine:

- (1) Whether other occupations operating on a commission basis are unable to pass on the excise tax to the customers and the reasons therefor;
- (2) The actual tax burden of those occupations which are unable to pass on the excise tax;
- (3) The revenue impact of amending the present excise tax law; and
- (4) Findings and recommendations.

The basic fact situation involved in this study may be described as follows: the taxpayer sells a product or performs a service for which the taxpayer receives the price, out of which the taxpayer is entitled to receive a certain percentage as commission. The company for which the taxpayer works is subject to a tax on the entire price whereas the taxpayer is liable for an excise tax only on the commissions received. The issue is whether the taxpayer is able to pass the excise tax on to the customer. Note that this study's focus is on the ability to pass on the tax, i.e. whether there are any laws prohibiting the passing on of the tax, and not whether due to agreements or business practices the taxpayer decides not to pass on the tax.

## Chapter II

### APPLICABILITY OF THE EXCISE TAX TO COMMISSIONS

#### PROBLEM FACING INSURANCE AGENTS

It is necessary to have a basic idea of the different types of insurance agents and the structure under which these agents work. A general agent is one authorized by the insurer, among other duties, to solicit insurance applications, effectuate and countersign insurance contracts, collect premiums, and appoint subagents and solicitors.<sup>1</sup> A subagent is one appointed by a general agent or by a domestic insurer to solicit insurance applications, effectuate and countersign insurance contracts if so authorized, collect premiums, and appoint solicitors.<sup>2</sup> A solicitor is one appointed by a general agent, subagent, or domestic insurer to solicit insurance applications and to collect premiums.<sup>3</sup> The appointment and qualifications of general agents, subagents, and solicitors are regulated by the state insurance law.

As used in this study, the term "insurance agent" includes solicitors, general agents, and subagents.

The sale of an insurance policy, then, may involve one or more of the different types of insurance agents described above. The insurance solicitor, general agent, or subagent sells an insurance policy to a client who pays the premium (or part of it) to the agent. The insurance agent turns over the premium paid to the insurance (insurer) company and in turn receives a certain percentage as commission from the company.

It should be noted that the insurance company generally is liable for an insurance premium tax with rates varying from .8775 per cent to 3.8025 per cent, depending upon the type of insurance sold and whether the insurer is a domestic company or not.<sup>4</sup> The tax is levied on the amounts received as premiums with various deductions allowed for

premiums returned, dividends paid, and reinsurance accepted. The insurance company, however, is not allowed to deduct either commissions paid to the insurance agent or excise taxes paid by an agent. Insurance companies liable for the insurance premium tax are exempt from the general excise tax.<sup>5</sup>

Insurance agents are liable for the excise tax on commissions received at different rates, the solicitor at 2 per cent<sup>6</sup> and general agents and subagents at 4 per cent.<sup>7</sup> Where the commissions are divided among several insurance agents, each agent is liable for the excise tax only on that portion of the commissions received.<sup>8</sup> The insurance agent may have one of two different relationships with the insurance company. The agent may be either an employee in which case, as such, is not subject to the excise tax<sup>9</sup> or the agent may be an independent contractor. An independent contractor, unlike the employee, is allowed discretion in deciding how to get the work done, being held to answer to the company only for the result of the work. The Department of Taxation has adopted guidelines on who qualifies as an independent contractor similar to the principle stated herein.<sup>10</sup>

The problem which is the focus of this study arises because insurance solicitors, general agents, and subagents who are in an independent contractor status are prohibited by section 431-424, Hawaii Revised Statutes, from passing on the excise tax to the clients. The insurance company and its agents are prohibited by this section from charging any fee, compensation, or consideration for insurance which is not included in the premium specified in the policy which premium must be approved by the insurance commissioner. The premium stated in the policy must be inclusive of all fees, charges, premiums, or other consideration. It should be noted that section 431-424, Hawaii Revised Statutes, does not prohibit the excise tax from being indirectly passed on to the customer by being included in the premium.

## LISTING OF OTHER OCCUPATIONS

The Department of Taxation provided the Office of the Legislative Reference Bureau with a list of 30 occupations which operate on a commission basis and which are subject to the general excise tax.

- (1) Advertising agencies
- (2) Appliance salespersons
- (3) Art galleries
- (4) Automobile salespersons
- (5) Barbers
- (6) Book salespersons
- (7) Catalog salespersons
- (8) Cemetery plot salespersons
- (9) Coin operated machines
- (10) Collection agencies
- (11) Encyclopedia salespersons
- (12) Finders fees
- (13) Fishermen
- (14) Fuller brush salespersons
- (15) Hairdressers
- (16) Home products salespersons
- (17) Jewelry salespersons
- (18) Magazine salespersons
- (19) Manufacturer's representatives
- (20) Mortuary salespersons

- (21) Mutual fund salespersons
- (22) Pre-cut home salespersons
- (23) Real estate brokers
- (24) Securities salespersons
- (25) Shoe salespersons
- (26) Taxi drivers
- (27) Travel agents
- (28) Vacuum cleaner salespersons
- (29) Vinyl siding salespersons
- (30) Wig and other hair-piece salespersons

The occupations listed are subject to a 4 per cent excise tax as: sellers of tangible personal property; sales representatives; service businesses; or retailers.<sup>11</sup> Some of the occupations listed are subject to state regulation.<sup>12</sup> The listed occupations, however, are generally not prohibited from passing on the excise tax by statute.

The focus of this study, as requested in Senate Resolution No. 456, S.D. 1, is on statutory prohibitions, imposed under state, county, or federal law, preventing the occupations listed from passing on the excise tax to the customers, and not on nonstatutory barriers preventing the tax from being passed on. Thus, the fact that the independent contractor does not pass on the tax because of business practices or custom, contractual agreements, convenience, or stiff economic competition is not an area of concern for the State because the State has not imposed such barriers. Most of the listed occupations which pay the entire excise tax without passing it on appear to do so because of nonstatutory reasons and not because of any statutory prohibition and are therefore not considered in detail in this study.

OCCUPATIONS WHICH CAN NOT PASS ON TAX AND REASONS THEREFOR

Travel agents and taxicab drivers are the only occupations listed besides insurance agents which apparently can not statutorily, pass on the excise tax to the customers. A travel agent receives a commission on each airline ticket sold by the agent from the airline and is liable for a 4 per cent excise tax on the commission.<sup>13</sup> It should be noted that the airline is subject to a 4 per cent public service company tax (at least for business done in Hawaii), but not the excise tax.<sup>14</sup>

Section 1373 of Title 49 U.S.C. prohibits travel agents from passing on the excise tax to the customer due to the sale or obtaining of airline tickets.<sup>15</sup> It should be noted, however, that the sale of airline tickets constitutes only a part of the travel agent's business income, and that there is no statutory prohibition to prevent the travel agent from passing on the excise tax for nonairline business, e.g. tours.

Section 12-1.9, Revised Ordinances of the City and County of Honolulu, apparently prohibits taxicab drivers from passing on the 4 per cent excise tax<sup>16</sup> levied on commissions received to the customers. It should be noted that the taxicab company is liable for a 4 per cent excise tax on gross income without any deduction for commissions paid to the drivers or excise taxes paid by the drivers.<sup>17</sup>

Section 12-1.9, Revised Ordinances of the City and County of Honolulu, is ambiguous as to whether taxes are prohibited from being passed on to customers.<sup>18</sup> Subsection (a) of section 12-1.9, Revised Ordinances of the City and County of Honolulu, prohibits the taxicab driver or company from charging or causing to be charged fares other than as provided therein, with no mention of taxes. Subsection (c) states that no other charges shall be made except as provided therein.

Thus, depending upon how broadly or narrowly "fares" and "charges" are interpreted, section 12-1.9, Revised Ordinances of the City

and County of Honolulu, could be construed to prohibit taxicab drivers from passing on the excise tax to the customers. The Office of the Corporation Counsel of the City and County of Honolulu upon the request of this office rendered an opinion that section 12-1.9 of the Revised Ordinances of the City and County of Honolulu does prohibit taxicab drivers from passing on the excise tax.<sup>19</sup>

It should be noted that even if taxicab drivers could pass on the excise tax, both the drivers and companies are liable for an excise tax, on commissions and fares respectively, and it is unclear which of these two taxpayers should receive the amounts passed on to and paid by the customer.

#### ACTUAL TAX BURDEN

The taxpayer who is able to pass on the excise tax to the customer is actually paying only a small part of the excise tax. For example, where the excise tax rate is 4 per cent, the customer pays \$1.00 plus the tax (4 cents). The taxpayer is liable for a 4 per cent excise tax on the entire proceeds (price plus tax paid by customer) of \$1.04, i.e. 4.16 cents. Since the customer already paid 4 cents for taxes, the taxpayer actually pays only .16 cents for every \$1.04 in income, or an actual tax burden of .15 per cent.

Insurance general agents and subagents, travel agents, and taxicab drivers are liable for an excise tax of 4 per cent<sup>20</sup> which can not be passed on to the customers. The taxpayer who can not pass on the excise tax is liable for and must pay 4 cents for each \$1.00 in income, or an actual tax burden of 4 per cent.

The insurance solicitor is liable for an excise tax of 2 per cent<sup>21</sup> which can not be passed on to the customers. Thus, the insurance solicitor is liable for and must pay 2 cents for each \$1.00 in income, or an actual tax burden of 2 per cent.

## REVENUE IMPACT

For the fiscal year ending June 30, 1976, the State collected \$557,121 in excise taxes from insurance solicitors at the 2 per cent rate and \$6,376,669 in excise taxes from the other occupations operating on commissions at the 4 per cent rate. The Department of Taxation was unable to provide specific excise tax revenue figures for insurance general agents and subagents, travel agents, and taxicab drivers.<sup>22</sup> According to the Department of Regulatory Agencies, there are 488 general agents, 515 subagents, and 4,897 solicitors in Hawaii. These figures may give some idea of possible revenue loss from general agents and subagents by comparing the number of general agents and subagents with the number of solicitors. It should be noted, however, that these figures include both independent contractors, subject to the excise tax, and employees, not subject to the tax.

## SUMMARY OF OTHER STATES' TREATMENT

Arguments have been made that since most other states do not tax commissions received by insurance agents, such commissions should not be subject to the excise tax in Hawaii. Generally, most (37) states have a sales tax while Hawaii and a few other (10) states (including the District of Columbia) have a general excise, gross income, or similar tax. The tax applicable in 1 state is unclear, and 2 states do not have any applicable tax. The excise, gross income, or sales tax is usually complemented by a use tax.

The sales tax is a tax on the retail sale of property levied on the final consumer at the time of the sales transaction. The excise or gross income tax, on the other hand, is a tax on the privilege of doing business levied on the business and payable at monthly or quarterly intervals.<sup>23</sup>

The use tax, based on the use of a product within the state, is designed to apply where the sales or excise tax does not apply. For

example, the sales or excise tax does not apply to a sale which occurs outside the state. The use tax is levied to tax the product if the product is brought into the state for use, less any sales or use tax paid to other states.

Forty-two states do not tax insurance agents' commissions, including apparently all 37 sales tax states, 2 business privilege or gross receipts states, 2 states without taxes in this area, and 1 state whose applicable tax is unclear. Eight states with a gross receipt (or similar) tax similar to Hawaii's excise tax do tax insurance agents' commissions. The basic rationale for the nontaxation of commissions received by insurance agents in sales tax states is that the sales tax is a tax on property, and the sale of an insurance policy is basically a sale of services, not of property. Thus, the sales tax does not apply to commissions received for the sale of insurance policies. The excise tax, however, applies to the sale of services as well as to the sale of property.<sup>24</sup>

The authors of Hawaii's General Excise Tax: Prospects, Problems, and Prescriptions, refuted the applicability of sales tax rationale to Hawaii's excise tax as follows:<sup>25</sup>

But the Iowa Rule, along with the other state court views on services, really deals with an essentially different problem than that which faces Hawaii. Most state courts are wrestling with statutes which are retail sales taxes (i.e., single stage sales taxes) and which do not apply to service businesses. These courts are thus caught up in the practical problem of deciding how to rationalize the levying of the retail tax on the transfers of property at some single stage in the distribution process. Therefore, certain states have held that the tax should be levied on sales by the service business, others, that it should be levied on sales to the service business, seldom, if ever, both levels.... We offer this example to demonstrate that there is nothing particularly compelling or relevant about the application to Hawaii's tax problems of legal precedents made in other states.

The excise tax is different in scope of application from the sales tax, and the rationale of nontaxation of commissions received for the sale of

insurance policies in sales tax states does not apply to Hawaii's excise tax.

Arguments have also been made that since the insurance companies are already paying an insurance premium tax without any deduction for excise taxes paid by insurance agent, application of the excise tax to the agents' commissions received for the sale of premiums is double taxation. The sales tax is a tax on one transaction, i.e. the final sale, whereas the excise tax has a pyramiding application and is in fact designed to apply to as many transactions as possible.<sup>26</sup> The insurance sale situation is not treated any differently from the other occupations listed. Companies which contract with independent contractors on a commission basis are generally liable for a tax without any deduction for commissions paid out or taxes paid by the independent contractor, and the independent contractor is likewise liable for an excise tax without any deduction for taxes paid by the company. The excise tax specifically applies without any deduction for taxes paid by another taxpayer.<sup>27</sup>

## Chapter III

### FINDINGS AND RECOMMENDATIONS

#### SUMMARY

Of the various occupations listed by the Department of Taxation as operating on commissions and subject to the excise tax as independent contractors, only insurance general agents, subagents, and solicitors, taxicab drivers, and travel agents (at least as to commissions on airplane tickets) are statutorily prohibited from passing on the excise tax to the customers. The companies are subject to taxation without any deduction for commissions paid out or for taxes paid by the independent contractor.

The actual excise tax burden of the insurance solicitor is 2 per cent (2 cents for every \$1.00 of income). The actual tax burden of insurance general agents and subagents, travel agents, and taxicab drivers is 4 per cent (4 cents for every \$1.00 of income). The actual tax burden of a taxpayer who can pass on the excise tax to the customer, however, is only .15 per cent (.16 cents for every \$1.04 of income).

For the fiscal year ending June 30, 1976, the State collected \$557,121 in excise taxes from insurance solicitors at the 2 per cent rate and \$6,376,669 from the other occupations operating on commission. Specific revenue figures for insurance general agents and subagents, travel agents, and taxicab drivers are not available.

Most of the other (37) states impose a sales tax whereas Hawaii and a few (10) other states (including the District of Columbia) impose an excise or gross income tax, with 3 states either with no tax or whose tax applicability is unclear. Forty-two states, including 37 sales tax states, do not tax commissions received by insurance agents for the sale of insurance policies, whereas 8 states with taxes similar to Hawaii's excise tax do tax the commissions. The basic rationale for the nontaxation of

insurance agents' commissions in a sales tax jurisdiction is that the sales tax is essentially a tax on property and does not apply to services. The sale of insurance is considered a sale of services by the agent and not subject to the sales tax. The excise tax, however, is a privilege tax levied on both property and services and is very different from the sales tax. Thus, the sales tax states' rationale for nontaxation of commissions is inapplicable to the excise tax.

The excise tax is applied to commissions received for the sale of insurance even though the insurance company is also liable for an insurance premium tax for basically the same (sales) transaction. Neither the company nor the agent receives any deduction in tax liability for the taxes paid by the other person. The argument that taxation of both the company and the insurance agent is double taxation (and thus insurance agents should not be taxed) is refuted by the fact that the other occupations which operate on a commission basis have a similar tax situation, i.e. companies are subject to a tax on the entire proceeds and the independent contractor is subject to an excise tax on commissions without either taxpayer allowed any deductions for taxes paid by the other person. The excise tax specifically applies without any deductions for losses, costs, or taxes, etc.

#### ALTERNATIVES

The alternatives presented for legislative consideration (as to insurance agents) are:

- (1) Maintaining the present excise tax and insurance laws;
- (2) Adjustment of insurance premium rates to provide for sufficient commission to cover the excise tax;
- (3) Exempting insurance agents from the excise tax, or reducing excise tax rates for insurance agents; or
- (4) Allowing insurance agents to pass on the excise tax set at the rate of 4 per cent.

### Alternative I: Maintaining The Present Law

The arguments for maintaining the present excise tax and insurance laws as to insurance general agents, subagents, and solicitors are that:

- (1) The 2 per cent excise tax rate on solicitors (instead of the 4 per cent rate) is already a compromise solution to help the solicitors who can not pass on the excise tax;
- (2) The application of the excise tax to insurance solicitors alone brought in \$557,121 in revenue during the fiscal year ending June 30, 1976, with additional unknown revenue from taxation of insurance general agents and subagents;
- (3) The other alternatives for legislative action will increase costs for the consumer (in either higher premium rates or in passing on the excise tax) or lose revenue (in exemption of insurance agents from the excise tax or in allowing a lower excise tax rate);
- (4) Amending the present law to accommodate insurance agents may set a precedent for similar changes to accommodate travel agents and taxicab drivers, thus resulting in even higher costs for the consumer or in greater loss of revenue; and
- (5) The problem arises because of the rigidity of the contract between the insurer and the agent in not allowing an increase in commissions to cover the excise tax, and not because of state law.

### Alternative II: Arguments in Favor of Some Change in Present Law

The arguments in favor of maintaining the present excise tax and insurance laws are subject to criticism. The fact that insurance solicitors are subject to only a 2 per cent excise tax is not much of a compromise solution. The actual tax burden of insurance solicitors is 2 per cent compared with the actual tax burden of .15 per cent for taxpayers who can pass on the excise tax. Furthermore, the actual tax burden of insurance general agents and subagents is 4 per cent.

While it is true that increasing the premiums or allowing insurance agents to pass on the excise tax results in increased costs for the consumer, the situation would not be any different from the majority of

occupations which can pass on the excise tax. It appears unfair to force insurance agents to pay the entire excise tax while allowing 28 other occupations operating on commissions to pass on most of the excise tax to the customers.

Travel agents appear to be prevented by federal law from passing on the excise tax paid on commissions for airline tickets directly to the customers. Arguments could be made that passage of legislation for insurance agents: would open up a floodgate of similar requests from travel agents; is inequitable since travel agents would not be helped; and is unnecessary since travel agents are apparently able to handle the prohibition against passing on the tax, and insurance agents should be able to do likewise.

The fact that travel agents appear to be able to live with the statutory inability to pass on the excise tax, however, does not necessarily mean that insurance agents should also be able or willing to do likewise. Travel agents are in a situation different from that of insurance agents.

The situation of travel agents can be distinguished from that of insurance agents. The travel agent may have to accept the prohibition against passing on the tax and not seek state legislation to repeal the prohibition because the prohibition is based on a federal statute. State legislation would be ineffective in making any changes in this area. The travel agent is prohibited from passing on the excise tax in relation to the sale or obtaining of airline tickets. Airline tickets, however, play only a small part of the travel agent's business, and travel agents can help themselves pay for the excise tax by passing on the tax or increasing the prices in other parts of the business, e.g. in tours.

State legislation would be effective, however, to amend or repeal the state statutory prohibition against insurance agents passing on the excise tax. Furthermore, the insurance agent's main business is

composed of only one factor producing income, the sale of insurance policies. Unlike the travel agent, the insurance agent has no other area of business in which the insurance agent is allowed to pass on the excise tax and has no control over the prices. The insurance agent is prohibited by a state statute from passing on the tax, and state legislation sought by the agent could effectively remedy the problem.

The argument that the basic problem is one of contract between the insurance company and the agent, and that the agent should bargain for higher commissions to cover the payment of the excise tax, is not economically realistic. As stated before, the focal point of this study is that the problem (prohibiting the passing on the excise tax) is one of statute, not of contractual or other nonstatutory reasons. The problem revolves around the presence of a state statute which prohibits the passing on of the excise tax, a statute which does not exist for 28 other occupations operating on commissions.

It is furthermore economically unrealistic to expect insurance agents to possess sufficient bargaining position to force the insurance companies to reduce the companies' profit in order to cover the agents' payment of the excise tax. According to Mr. Wayne Minami, who as the Director of Regulatory Agencies is the insurance commissioner, the payment of excise taxes by the agent is considered in decisions on premium rate setting. There is apparently no statute however, to assure that the insurance company passes along that part of the rate increase due to the agent's payment of the excise tax to the agent.

Based on the foregoing reasons, it may be argued that the present excise tax and insurance laws as to the insurance agents' ability to pass on the excise tax should be changed. The various alternatives for some change in the law are presented in the following.

Alternative IIA: Adjustment of Insurance Premium Rate

One possible method to change the present insurance law with respect to insurance agents is to adjust the premium rates to allow

insurance agents a sufficient commission to pay the excise tax, at least in parity with the actual tax burden of .15 per cent of other occupations. Casualty, vehicle, surety, property, marine, and transportation insurance rates are regulated under the Hawaii insurance law. Excessive, inadequate, or unfairly discriminatory rates are prohibited.<sup>2</sup> Some supervision, however, may be necessary to assure that the insurance in premiums is passed along from the insurer to the insurance agents and not kept as additional profit by the insurers. Life and disability insurance rates are not regulated under the Hawaii Insurance law, and adjustment of the premiums for life and disability insurance may be difficult. Adjustment of the premiums was one of the recommendations adopted by the Department of Taxation in its 1976 study on this subject.<sup>3</sup>

#### Alternative IIB: Excise Tax Exemption

An exemption would eliminate the excise tax liability for insurance agents, thus placing the insurance agents in a more favorable position than the other occupations operating on commissions which would still be liable for the excise tax (although at a reduced actual tax rate due to the ability to pass the tax on). Equitable principles only require that state statutes treat insurance agents similar to, and not better than, the other occupations.

The Department of Taxation in its 1976 study in this area recommended that if insurance premium rates could not be adjusted, that all insurance solicitors be considered employees for general excise tax purposes, thus exempting the solicitors from the excise tax.<sup>4</sup> The Department of Taxation also recommended that the tax status of general agents be determined based on each general agent's contract with the insurance company.

#### Alternative IIC: Reduction in Rates

Another possible approach is to reduce the excise tax rates for insurance agents from the current 2 per cent for solicitors and 4 per cent for general agents and subagents to .15 per cent, the actual tax burden of occupations which pass on the excise tax. This reduction in tax rates

would place insurance agents in a similar tax position to other occupations which pass on the excise tax.

The .15 per cent excise tax rate is the actual tax rate and burden of those occupations subject to the 4 per cent rate which choose to pass on the excise tax to the customers. There is no need to eliminate the statutory prohibition against insurance agents passing on the excise tax since the .15 per cent places the agents and solicitors in a similar tax position to those occupations which do pass on the 4 per cent excise tax. Reduction of the excise tax to .15 per cent, however, places the insurance agents in a slightly different position from the other occupations which are subject to the 4 per cent excise tax and which can pass the tax on. These other occupations are faced with a competitive situation and must decide whether to pass on the tax and risk losing customers to a person who does not pass on the tax. Since the .15 per cent rate would be set for the entire insurance industry and can not be passed on, insurance agents are not faced with the competitive decision of passing or not passing on the tax and yet receive the actual tax rate as if the agents had decided to pass on the tax.

CAVEAT: FINDING OTHER REVENUE SOURCES

The State received \$557,121 in excise tax revenues from insurance solicitors and an additional, unknown sum from general agents and subagents for the fiscal year ending June 30, 1976. An excise tax exemption or reduction in rates for insurance solicitors, general agents, and subagents would result in a substantial revenue loss to the State. For example, a reduction from 2 per cent to .15 per cent for insurance solicitors would reduce revenues from \$557,121 to about \$41,784, a loss of about \$515,337.

$$\frac{\$557,121}{2} = \frac{x}{1.5}; 2x = 835.7; x = \$41,784$$

Losses would be even larger if general agents and subagents are exempted. Other sources of revenue might have to be found to replace

the deficit created by an exemption or reduction in rates. The tax on the insurance premium could be increased to cover the deficit. With the assistance of the Department of Regulatory Agencies and based upon a revenue figure of \$431,000 in 1975 from insurance solicitors alone, if the tax on insurance solicitors was dropped completely, the tax on insurance premium for:

- (1) Domestic life insurance companies would have to be raised from 1.755 per cent to 1.83 per cent; for nondomestic insurers, from 2.925 per cent to 3.06 per cent;
- (2) Domestic casualty/fire insurers would have to be raised from 2.635 per cent to 2.75 per cent; for nondomestic insurers, from 3.8025 per cent to 3.97 per cent;
- (3) No changes are made for ocean marine and surplus line insurance since taxes from such insurance is very small.

RECOMMENDATION I: ALLOW AGENTS TO PASS ON TAX

It is the recommendation of the Legislative Reference Bureau that insurance general agents, subagents, and solicitors be allowed to pass on the excise tax to the customers. To accomplish this recommendation, it is necessary to amend section 431-424, Hawaii Revised Statutes, to allow the agents to add on the excise tax (on commissions) to the premium price. It should be noted that insurance companies are liable for an insurance premium tax and are also prohibited from passing on the premium tax by section 431-424, Hawaii Revised Statutes. Section 431-424, Hawaii Revised Statutes, should be amended to allow the passing on of the agent's excise tax while maintaining the prohibition against the company's passing on of the premium tax.

It is also recommended that to achieve complete parity with those occupations which can pass on the excise tax (of 4 per cent), the current 2 per cent excise tax rate for insurance solicitors be raised to 4 per cent. The 2 per cent was set as a compromise because of the inability of solicitors to pass on the tax and is no longer justified under the recommendation.

The sale of an insurance policy may involve payments due to the sale involving more than one agent. For example, the solicitor may receive a certain percentage of the premiums as commission, and the general agent may receive a certain percentage out of the same premiums as overwrite, a kind of commission, for services performed. It is the recommendation of the Legislative Reference Bureau that all insurance agents (solicitors, general agents, and subagents) be allowed to pass on the excise tax on fees (commissions) received for the sale of the policy. Thus, in the example herein, both the insurance solicitor and the general agent should be allowed to pass on the tax of 4 per cent on commissions. It may appear that it is double taxation to allow 4 per cent to be imposed twice (on two different commissions). In reality, however, the 4 per cent excise tax is imposed on a lump sum (all the commissions combined) and is still smaller than if an excise tax had been imposed on the entire price (instead of just on commissions) as in the case of a sale of goods.

#### IMPLEMENTATION

Any legislative implementation of this recommendation should provide for a method of collecting the excise tax to be paid by the customer along with collection of the premiums. Commissions are apparently paid to the insurance agents at the time that premiums are received by the insurance company.<sup>5</sup> Thus, if premiums are paid periodically, the insurance agent receives the commission periodically, and if premiums are paid in a lump sum, then the agent receives the commission in a lump sum. Generally the insurance company handles the billing and collection of premiums. The insurance agent, however, may at times collect the first premium at the time the insurance policy is sold.

Legislation should provide for collection of the excise tax (on commissions) from the customer at the time premiums are paid, whether collection is made by the insurance agent at the sale, or by the insurance company. Collection of the excise tax should be made the responsibility of the person (agent or company) collecting the premium, and in the case

of the insurance company, some safeguards are required. It is necessary that the insurance company know which agents are independent contractors subject to the tax and which of these agents pass on the excise tax, and thus mandatory collection and maintenance of the necessary information by the company is necessary. Collection of the excise tax by the insurance company and payment of the tax over to the agent should be made mandatory, otherwise, the company might not undertake the necessary workload.

The primary reason for the recommendation that insurance agents be allowed to pass on the excise tax is that it would be equitable to do so. The actual tax burden of the solicitor (2 per cent) and of the general agent and subagent (4 per cent) is much greater than the actual tax burden of the taxpayer (.15 per cent) who is allowed to pass on the excise tax to the customer. A prohibition against passing on the excise tax to the customers is apparently imposed on only 3 out of the 31 occupations which operate on commissions.

The other alternatives for possible legislative action, the adjustment of premium rates and the tax exemption or reduction in excise tax rates, are unnecessarily complicated. Increases in premiums would have to be calculated to cover the excise tax and may be subject to changes from year to year. Under the proposals for excise tax exemption or reduction in tax rates sources to replace the lost excise tax revenue would have to be found, and an exemption might place the insurance agents in a superior position to that of other occupations instead of just in parity.

The recommendation that insurance agents and solicitors be allowed to pass on the excise tax, set at 4 per cent, to the customers is simple and feasible. The practice of allowing the taxpayer to pass on the excise tax is allowed in the majority of the occupations currently operating on commissions without apparent difficulty. There is no need to calculate changes from year to year due to changing premium rates, commission rates, other tax rates, or in business income of agents. There is also no

need to find substitute revenue since under this recommendation, the excise tax is still imposed, in fact at an increased rate (4 per cent instead of 2 per cent for solicitors). The only difference is that under this recommendation, the customer, and not the agent, would be paying most of the tax.

ALTERNATIVE RECOMMENDATION: REDUCE TAX RATES

In lieu of adopting the first recommendation made, an alternative recommendation is to reduce the excise tax rate from 2 and 4 per cent, respectively, for solicitors and general agents and subagents, to .15 per cent.

Allowing insurance agents to pass on the excise tax might raise problems of implementation. Insurance companies may not be willing or able to undertake the expense of record keeping, collection, and distribution of excise taxes passed on by the insurance agents to the customers, especially when the company does not directly benefit from such a practice. The legislature may find that allowing insurance agents to pass on the tax may prove to be too difficult to implement.

It is recommended therefore, as an alternative, that the excise tax rates for insurance agents be reduced, from 2 per cent for solicitors and 4 per cent for general agents and subagents to .15 per cent. The rate of .15 per cent is the actual tax rate (burden) for those occupations which are subject to a 4 per cent excise tax rate and which pass on the tax. This alternative would subject insurance agents to the same effective rate as would apply if the agents could and did pass on the tax, without having to actually pass on, and collect the tax. Under this recommendation, the statutory prohibition against insurance agents passing on the tax would be maintained since reduction of the tax rates accomplishes the same purpose as repeal of the prohibition. The principal drawback of this recommendation is that alternative sources of revenue would have to be found to cover the deficit caused by a reduction in rates. One possibility might be an increase in the insurance premium tax.

## OTHER RECOMMENDATIONS:

### II. Other Occupations

It is further recommended that no legislative change be made as to the status of the 28 occupations which are not subject to any statutory prohibition against passing on the excise tax. The fact that nonstatutory pressure such as contractual agreements may inhibit the passing on of the excise tax does not demand a statutory solution.

### III. Travel Agents

The Legislative Reference Bureau recommends that the present law on excise taxes as applied to travel agents be maintained. The statutory prohibition against travel agents passing on the excise tax for the sale or obtaining of airplane tickets is a federal statute, and state legislation would not be effective in changing the federal statute in this area. Furthermore, the prohibition against passing on the excise tax is only in the sale or obtaining of airline tickets, an area which makes up only a small part of the travel agent's business. The travel agent could cover the payment of excise taxes as to airline tickets by increasing the prices in the other parts of the business, e.g. tours, and could pass on the excise tax in these other areas.

### IV. Allow Taxicab Drivers to Pass on Tax

Section 12-1.9, Revised Ordinances of the City and County of Honolulu, appears to prohibit taxicab drivers from passing on the excise tax to the customers. Representatives of two taxicab companies on Oahu indicated that they were not sure whether the ordinance actually prohibited the passing on of the tax and were not aware that the ordinance might be interpreted to prohibit passing on the tax. The Office of the Corporation Counsel of the City and County of Honolulu rendered an opinion that the ordinance did prohibit passing on of excise taxes.

It is the recommendation of the Legislative Reference Bureau that legislation be enacted to permit taxicab drivers to pass on the excise tax.

### IMPLEMENTATION

The most feasible method of allowing taxicab drivers to pass on the tax is to enact legislation providing that local ordinances (such as section 12-1.9 of the Revised Ordinances of the City and County of Honolulu) shall not prohibit taxicab drivers from passing on the excise tax.

Lowering the excise tax rate to .15 per cent or a tax exemption does not appear feasible since there do not appear to be other taxes which could help cover the deficit thus created. At least with the insurance agents, perhaps, the insurance premium tax could be raised to cover the deficit.

Raising the taxicab rates also does not appear feasible. This method would require the state legislature setting rates in an area now handled by the county councils. There is also no assurance that the companies would pass along the increase in rates to taxicab drivers.

The basic reason for legislation allowing taxicab drivers to pass on the excise tax is similar to that for insurance agents, i.e. principles of equity. The vast majority of occupations which operate on commissions can pass on the tax. The only occupations which are statutorily barred from passing on the tax are insurance agents (recommendation: allow to pass tax on); travel agents (federal law and thus state legislation ineffective); and taxicab drivers.

Based on conversations with a representative of a large local taxicab company, it appears that taxicab drivers are reluctant to pass on the tax (and might not do so even if permitted) because passing on the excise tax would be a great inconvenience. Drivers would have to carry much small change, compute and collect the tax, and take valuable time

which could be used to carry more passengers. The possibility of tips may also help pay for the tax.

The possibility that taxicab drivers may choose not to pass on the tax is not crucial. The fact exists that due to a local ordinance, taxicab drivers are apparently statutorily unable to pass on the tax, and as stated before, the focus of this study is on statutory inability to pass on the tax and not on decisions not to pass on the tax due to business reasons. Equitable treatment of taxicab drivers would indicate that legislation be enacted to remove any statutory barriers to passing on the tax and leaving the decision of whether to pass on the tax to the drivers.

#### CONSIDERATION OF AFFECTED PARTIES AND AGENCY RESPONSES TO STUDY

The preliminary draft of this study was sent to: the Director of Taxation; Director of Regulatory Agencies; Mr. Mitsuru Fujimoto; Mr. Tommy Lee, assistant to Mr. Fujimoto; Mr. Thomas Anderson, president of the American Society of Travel Agents; the managers of SIDA of Hawaii, Inc., Charley's Taxi, and Trade Wind Taxi; Mr. Ernest McCaughan of the Hawaii Insurer's Council; and Mr. Harry Albright of the Hawaii Insurance Association. Responses were received from the Director of Regulatory Agencies, Mr. Fujimoto, Mr. Albright, and SIDA of Hawaii, Inc.<sup>6</sup>

Mr. Fujimoto, representing various insurance agents, makes two principal points:

- (1) This study's recommendation that agents be allowed to pass on the tax would be difficult to implement because recovery of excise taxes paid where commissions are returned to the company would be difficult; payment and computation of contingent (bonus) commissions would be difficult to compute and to collect taxes on; and administrative and accounting problems would arise if agents passed on the tax.
- (2) Since the passing on of the tax is so difficult, a reduction in the excise tax rate is a better solution.

The Legislative Reference Bureau notes that many of the difficulties which would be present under this study's recommendation that agents be allowed to pass on the excise tax are present under existing law, and the solutions for these difficulties also are present under existing law. For example, the Department of Taxation has under existing procedures, a method for insurance agents to deduct from gross income any commissions which are returned to the company, thereby reducing the excise tax to be paid later on. Computation and passing on the excise tax would not be much more difficult for insurance agents and insurance companies under this study's recommendation than it is for insurance agents under present law or for the other 28 occupations which now appear to compute and pass on the tax. The Legislative Reference Bureau concludes that the difficulties of implementation allowing the insurance agents to pass on the excise tax can be overcome by carefully drafted legislation and solutions under present law and procedures.

In response to Mr. Fujimoto's second comment, the Legislative Reference Bureau notes that Mr. Fujimoto cites a tax reduction to .015 per cent, apparently a mistake in citing this study's recommended .15 per cent reduction. The principal objections to this reduction in the excise tax, loss of revenue and elimination of a competitive decision, are discussed in this study.

Mr. Albright, representing certain insurance agents, apparently favors a reduction of the excise tax to a .15 per cent, citing difficulties in implementation allowing agents to pass on the tax. The Legislative Reference Bureau reiterates its response to these arguments similarly presented by Mr. Fujimoto in the preceding paragraphs.

SIDA of Hawaii, Inc. submitted some comments to which the Legislative Reference Bureau has no response.

Mr. Wayne Minami, Director of Regulatory Agencies, offered four basic comments:

- (1) The scope of this study is limited to the issue of the agent's ability to pass on the excise tax and as such is unduly narrow, leaving out important issues which should also be considered;
- (2) Not all insurance rates are regulated by the insurance commissioner, and some rates are set by companies nationwide;
- (3) This study fails to address the unique characteristics of a commission salesman; and
- (4) Passing on the excise tax presents difficult problems.

The Legislative Reference Bureau's position on the first comment, that the scope of this study is unduly narrow, is that this study purposely centers on the issue of the agent's statutory ability to pass on the excise tax because Senate Resolution No. 456, S.D. 1, requesting this study, specifically focuses on the ability of commission occupations to pass on the tax and the ramifications thereof. The study was not designed to, nor could it have been performed in the time allotted if it had to, address all issues in depth. However, the issues proposed by Mr. Minami have, to an appropriate extent, been considered in the conduct of this study.

Mr. Minami asks whether insurance companies take the excise tax into consideration when commission rates are set and asserts that, if so, it is inequitable to allow the tax to be passed on. The Bureau does not have sufficient resources or access to necessary material to undertake a study to answer Mr. Minami's question. To do so would require writing to every insurance company with agents operating in Hawaii. Even if the excise tax is considered in setting commission rates, and it is not clear that this is so, nor do we believe this subjective intent can be proved one way or another; then it is also possible that the rates would be reset and lowered if the recommendation is adopted and the tax could be passed on, if only due to economic competition.

Mr. Minami also asserts that section 431-424, Hawaii Revised Statutes, is essential to regulation of insurance premiums assuring the customer that the price paid is the same as that approved by the insurance commissioner and that the Bureau's recommendation to amend this section of the Hawaii Revised Statutes and to allow the excise tax to be passed on would erode safeguards for the consumer. Section 431-424, Hawaii Revised Statutes, prohibits adding extra charges to the premium and in this sense does help premium rate regulation. Amendment of section 431-424, Hawaii Revised Statutes, allowing excise taxes to be added on, while maintaining the prohibition against other charges from being added on, should not erode any regulatory safeguards for the consumer. The excise tax is capable of precise calculation, and the customer could check, by simple arithmetic, whether the price, minus the tax, is in fact the price approved by the insurance commissioner. This is not the case of a company trying to surreptitiously include an extra completely unauthorized charge. The excise tax under this study's recommendation is specifically authorized to be passed on to the customer, and the customer could be informed of this. Furthermore, as pointed out by Mr. Minami, life and disability insurance (except credit life and disability), are not regulated by the insurance commissioner, and Mr. Minami's comment would not apply to these types of insurance.

In response to the second comment, that not all insurance premiums are regulated, the Bureau has amended the final draft of this study to reflect this. Mr. Minami asserts that the rates of these unregulated types of insurance, take into consideration commissions and excise taxes and that the life insurance rates are generally uniform nationwide. These two assertions appear to be contradictory. If the rates are set uniformly nationwide, then the very uniformity of the rates does not consider the excise tax since as noted in this study, only a few states have an excise tax or tax insurance agents as does Hawaii. Furthermore, there is no indication of any data to support the conclusion that excise taxes are taken into consideration in setting rates, especially since life and disability insurance rates are not within the regulatory responsibilities of the Department of Regulatory Agencies.

Observing that this study does not address the unique characteristics of a commission salesman, Mr. Minami asserts that it is not necessarily always true that other occupations are permitted to and do pass on the tax. He cites the example of a vacuum cleaner salesman, the sales representative, and the company, all competing for the excise tax collected from the customer. Mr. Minami asserts that depending upon who has the bargaining power, one taxpayer, e.g. the company, may take all of the excise tax passed on and force the others to absorb the loss. As stated several times throughout this study, this study does not deal with inability to pass on the tax due to contractual agreements or bargaining power. The central issue in this study is whether there are any statutory prohibitions against passing on the tax. The problems cited in Mr. Minami's example do not extend to insurance agents under this study's recommendation because insurance companies are not liable for excise taxes and thus could not apply any excise tax collected to the company's tax liability. Any possible conflict between the bargaining powers different insurance agents would be settled by this study's provision that all agents be allowed to pass on the excise tax, even as to commissions from the same sale.

Mr. Minami comments that the agent would have to disclose the commission in order to explain the excise tax. This disclosure and explanation by the agent does not appear to present any difficulties.

Mr. Minami also asserts that the Bureau's statement, that it is economically unrealistic to expect insurance agents to possess sufficient bargaining power to force companies to reduce profit to cover the excise tax, should be reviewed. As cited by Mr. Minami, there may be exceptions where the agent does exceptional work and receives a higher (bonus) commission therefor. The fact that some agents can bargain for and receive sufficient commission, however, does not necessarily apply to or help the other agents who for some reason or another, do not receive bonuses or sufficient commissions and again this speaks to contractual arrangements and not to statutory constraints.

With respect to the fourth comment that passing on the excise tax presents practical problems, Mr. Minami asks who will be responsible for refunding excise taxes paid back to the customer in the event the policy is canceled and asserts that it is evident that the expenses involved in refunding the excise tax would be costly. Since the company collects premiums, including the commissions, it would collect the excise tax under the recommendation; and in the event of a refund, it appears that the company should refund excise taxes at the same time the company refunds premiums to the customer. It is not evident that the tax refunds would be very costly. Since the company has to process the refund of the premium anyway, including a refund of excise taxes along with the premium does not necessarily add that much more in costs. The position of the Bureau on the difficulties of implementing its recommendation is discussed in response to Mr. Fujimoto's comments.

Mr. Minami also asserts that companies using employee salesmen may have a competitive edge over companies which use independent contractor salesmen. It is not clear whether passing on the excise tax would give an edge to companies using employee salesmen since these companies have expenses such as health insurance and unemployment compensation which the latter type of companies do not have. Before any definite statement on competitive edge can be made, access to and a study on the operations and profit and loss of all the insurance companies would have to be completed. Furthermore, the competitive edge, if any, which companies using employee salesmen would have already exists for the 28 other occupations, where some companies choose to use employees while others use independent contractors.

## FOOTNOTES

### CHAPTER I

1. See Appendix A.

### CHAPTER II

1. Hawaii Rev. Stat., sec. 431-361.
2. Ibid., sec. 431-362.
3. Ibid., sec. 431-363.
4. Ibid., sec. 431-318.
5. Ibid., secs. 237-23(5) and 431-320.
6. Ibid., sec. 237-23(7).
7. Ibid., secs. 237-13(6) and 237-16.
8. Ibid., sec. 237-18(f).
9. Ibid., secs. 237-7 and 237-24(6).
10. 41 Am Jur. 2d Independent Contractor, sec. 1; Hawaii, Department of Taxation, House Resolution No. 600, L. 1976 (Honolulu: 1976), p. 4.
11. Hawaii Rev. Stat., secs. 237-13(2), (5), (6), and (10) and 237-16.
12. Ibid., chapters 437, 438, 439, 441, 443, 467, 468, 469, 470, and 476.
13. Ibid., secs. 237-13 and 237-16.
14. Ibid., secs. 237-23(3), 239-5(a), and 239-6.
15. See Appendix B.
16. Hawaii Rev. Stat., secs. 237-13(6) and 237-16.
17. Ibid.

18. See Appendix B.
19. See Appendix B.
20. Hawaii Rev. Stat., sec. 237-13.
21. Ibid., sec. 237-13(7).
22. See Appendix C.
23. Hawaii Rev. Stat., sec. 237-9.
24. Ibid., sec. 237-13.
25. Arthur D. Little, Inc., Hawaii's General Excise Tax: Prospects, Problems and Prescriptions, Report to State of Hawaii, Department of Taxation (1968), pp. 23-24.
26. Ibid., p. 47.
27. Hawaii Rev. Stat., 237-3.

### CHAPTER III

1. Hawaii, Department of Taxation, House Resolution No. 600, L. 1976 (Honolulu: 1976), p. 5.
2. Hawaii Rev. Stat., secs. 431-692, 431-693, 431-712, and 431-713.
3. Hawaii, Department of Taxation, House Resolution No. 600, L. 1976 (Honolulu: 1976), p. 7.
4. Ibid., p. 8.
5. Telephone interview with Mitsuru Fujimoto, Business Men's Assurance Co., September 1, 1977.
6. See Appendix D.

A P P E N D I C E S

## APPENDIX A

(To be made one and twelve copies)

THE SENATE

NINTH

..... LEGISLATURE, 19 77

STATE OF HAWAII

S.R. NO.

456

S.D. 1

# SENATE RESOLUTION

## REQUESTING A STUDY OF CERTAIN ASPECTS OF THE GENERAL EXCISE TAX.

WHEREAS, a general excise tax is a tax on gross proceeds, and is by present practice passed on to the buyer by some sellers and not by others; and

WHEREAS, insurance solicitors, subagents, and general agents have their commissions taxed under the general excise tax law of the State; and

WHEREAS, this tax is imposed by section 237-13 of the Hawaii Revised Statutes, and paragraphs thereunder as applied may be levied on other occupations as well; and

WHEREAS, insurance solicitors, subagents, and general agents who are taxed in this manner appear to be unable to pass the tax on to their customers because of statutory restriction, as compared to others who may pass the tax on to their customers; and

WHEREAS, because the tax is not passed on and is placed upon gross commissions without deductions, a higher tax burden may be imposed on these occupations than on other occupations; and

WHEREAS, it should be determined if there are other occupations such as real estate salesmen, stockbrokers, and others in similar circumstances or if insurance solicitors, subagents, and general agents are alone in bearing this tax burden; and

WHEREAS, it appears that the general excise tax burden of insurance agents, subagents, and general agents may be inequitable, since due to their inability to pass on the tax their actual rate of tax may be ten per cent or more instead of two per cent in the case of insurance solicitors and in the case of general agents and subagents twenty per cent or more instead of four per cent; and

WHEREAS, the money used to pay commissions of insurance solicitors, subagents, and general agents is originally

taxed through revenues collected from the insurance companies; and

WHEREAS, the present interpretation and the existing laws must be scrutinized to determine whether inequity exists due to present practice, law, and enforcement; and, only after a careful determination of the persons being affected and the impact of modifying or eliminating such tax collection practices upon those persons and the State, may change take place; now, therefore,

BE IT RESOLVED by the Senate of the Ninth Legislature of the State of Hawaii, Regular Session of 1977, that the Office of the Legislative Reference Bureau with the cooperation and assistance of the departments of taxation and regulatory agencies is requested to conduct a study of the taxation of insurance solicitors, subagents; and general agents as stated herein, determine if other occupations are similarly situated, indicate why, and if, such persons are unable to pass on the general excise tax, determine the actual general excise tax burden of the occupations which cannot pass on the tax, give an estimate of the revenue impact of modifying the present law concerning these persons, and submit findings and recommendations of the study to the legislature before the convening of the Regular Session of 1978; and

BE IT FURTHER RESOLVED that the Department of Taxation shall assist the Office of the Legislative Reference Bureau in performing this study by submitting to the Bureau not later than August 1, 1977, a listing of the occupations whose commissions are taxed by the general excise tax, whether or not the occupations involved are able to pass on the tax, why these occupations are unable to pass on the general excise tax, if such reason is known, the actual general excise tax burden of these occupations and the revenues raised from the taxation of these occupations; and

BE IT FURTHER RESOLVED that the Department of Regulatory Agencies shall assist the Office of the Legislative Reference Bureau in determining how the occupations listed by the Department of Taxation operate in the commission area in order to determine if in fact they are unable to pass on the general excise tax and if any statutes or rules under its jurisdiction prevent such pass on; and

BE IT FURTHER RESOLVED that certified copies of this Resolution be transmitted to the Directors of the Office of the Legislative Reference Bureau, Taxation, and Regulatory Agencies.

## APPENDIX B

### HAWAII REVISED STATUTES

Sec. 431-424 Stated premium must include all charges.  
(a) The premium stated in the policy shall be inclusive of all fees, charges, premiums, or other consideration charged for the insurance or for the procurement thereof. This subsection shall not apply to surety or group insurance contracts.

(b) No insurer or its officer, employee, agent, solicitor, or other representative shall charge or receive any fee, compensation, or consideration for insurance which is not included in the premium specified in the policy.

### REVISED ORDINANCES OF THE CITY AND COUNTY OF HONOLULU

#### Sec. 12-1.9 Rate of Fare and Baggage Charge.

(a) No driver, owner, or operator of a taxicab or [fixed] taxi stand shall charge or cause to be charged, fares for the use of a taxicab, for purposes of hire, other than as provided herein and all taximeters shall be adjusted accordingly.

(b) Fares.

(1) Mileage Rate. For the first 1/8 of a mile or fraction thereof.....\$00.80  
For each additional 1/8 mile or fraction thereof.....\$00.10

(2) Waiting Time. For each minute or fraction thereof.....\$00.10

(3) Baggage or Parcel Charge. For each piece of baggage or parcel, excluding items such as purses, brief cases, airline hand bags, cameras, grocery bags (less than 25 pound size), parcels less than four cubic feet in size, collapsible wheel chairs.....\$00.25  
(The collection of such baggage or parcel charge may at the option of the taxicab driver be waived.)

(4) Surfboard(s) or Bicycle. For each surfboard or bicycle too large to be carried within the rear passenger compartment or trunk of the taxicab.....\$ 3.00

(5) Additional passengers in excess of four passengers. For each additional passenger in excess of four, except children under two years of age.....\$00.25

(c) Fares are only applicable to the use of the taxicab when actually occupied by or standing at the direction of the passenger for hire or when occupied by parcels or baggage transported for hire. No other charges shall be made for the use of a taxicab for hire except as provided herein.

(d) The aforesaid schedule of fares shall be printed in bold type letters, not less than 3/8 of an inch in height, and shall be posted within 12 inches of the taximeter so as to be readily visible to all passengers for hire.

UNITED STATES CODE

**S 1373. Tariffs of air carriers**

**Observance of tariffs; granting, soliciting, or accepting rebates**

(b) (1) No air carrier or foreign air carrier or any ticket agent shall charge or demand or collect or receive a greater or less or different compensation for air transportation, or for any service in connection therewith, than the rates, fares, and charges specified in then currently effective tariffs of such air carrier or foreign air carrier; and no air carrier or foreign air carrier or ticket agent shall, in any manner or by any device, directly or indirectly, or through any agent or broker, or otherwise, refund or remit any portion of the rates, fares, or charges so specified, or extend to any person any privileges or facilities, with respect to matters required by the Board to be specified in such tariffs except those specified therein. Nothing in this chapter shall prohibit such air carriers or foreign air carriers, under such terms and conditions as the Board may prescribe, from issuing or interchanging tickets or passes for free or reduced-rate transportation to their directors, officers, and employees (including retired directors, officers, and employees who are receiving retirement benefits from any air carrier or foreign air carrier), the parents and immediate families of such officers and employees, and the immediate families of such directors; widows, widowers, and minor children

of employees who have died as a direct result of personal injury sustained while in the performance of duty in the service of such air carrier or foreign air carrier; witnesses and attorneys attending any legal investigation in which any such air carrier is interested; persons injured in aircraft accidents and physicians and nurses attending such persons; immediate families, including parents, or persons injured or killed in aircraft accidents where the object is to transport such persons in connection with such accident; and any person or property with the object of providing relief in cases of general epidemic, pestilence, or other calamitous visitation; and, in the case of overseas or foreign air transportation, to such other persons and under such other circumstances as the Board may by regulations prescribe. Any air carrier or foreign air carrier, under such terms and conditions as the Board may prescribe, may grant reduced-rate transportation to ministers of religion on a space-available basis.

(2) No shipper, consignor, consignee, forwarder, broker, or other person, or any director, officer, agent, or employee thereof, shall knowingly pay, directly or indirectly, by any device or means, a greater or less or different compensation for air transportation of property, or for any service in connection therewith, than the rates, fares, and charges specified in currently effective tariffs applicable to such air transportation; and no such person shall, in any manner or by any device, directly or indirectly, through any agent or broker, or otherwise, knowingly solicit, accept, or receive a refund or remittance of any portion of the rates, fares, or charges so specified, or knowingly solicit, accept, or receive any privilege, favor, or facility, with respect to matters required by the Board to be specified in such tariffs, except those specified therein.

Air Transport Association  OF AMERICA

1709 New York Avenue, N.W.  
 Washington, D.C. 20005  
 Phone (202) 872-4000  
 August 29, 1977

Mr. Lester J. Ishado  
 Legislative Reference Bureau  
 State Capitol Room 004  
 Honolulu, Hawaii 96813

Dear Mr. Ishado:

Your recent letter to William M. Hawkins has been referred to me for reply. You explained that travel agents in Hawaii are subject to a 4% excise tax on the commissions they receive for the sale of air transportation. You sought an opinion on whether the travel agents could recapture that tax money by adding that amount to the passenger's bill for air transportation, or by obtaining reimbursement from the airlines for that amount.

Section 403(b) of the Federal Aviation Act of 1958, as amended, 49 U.S.C. Section 1373(b), provides in pertinent part:

"No air carrier . . . or any ticket agent shall charge or demand or collect or receive a greater, or less or different compensation for air transportation, or for any service in connection therewith, than the rates, fares, and charges specified in then currently effective tariffs of such air carrier . . ."

Since the cost of air transportation to the passenger must be that specified in the carrier's tariff, the travel agent may not charge a different figure to recoup his tax expenses.

Similarly, the travel agent may not receive remuneration from the carriers for incurred tax expenses. The remuneration of travel agents by carriers is strictly prescribed by Section VIII of the Air Traffic Conference Agency Resolution, a copy of which is enclosed for your reference. This Resolution has been filed with, and approved by, the Civil Aeronautics Board<sup>1/</sup> and the requirements contained therein must be scrupulously observed.<sup>2/</sup> The Resolution does not permit the carriers to reimburse travel agents for tax expenses.

1/ See e.g. ATC Agency Resolution Investigation, 29 CAB 258 (1959); Order 70-12-165.

2/ See generally Grueninger International Travel, Inc. v. Air Transport Association, 551 F. 2d 1324, 1326 (D.C. Cir. 1977).

Mr. Lester J. Ishado  
August 29, 1977  
Page 2

The extent of proper remuneration of an agent by a carrier is unambiguously set forth in the Air Traffic Conference Sales Agency Agreement which binds the agents and approving air carriers who are members of the aforementioned Air Traffic Conference Agency Resolution. Paragraph 8 of that agreement provides:

"As remuneration for the services performed by the Agent hereunder, the Carrier agrees . . . to pay the Agent as commission a percentage . . . of the fares and charges applicable to the air passenger transportation offered by the Carrier which is sold by the Agent hereunder. Such commission shall be accepted by the Agent as full compensation for its services rendered to the Carrier hereunder" (emphasis added).

Clearly reimbursement for taxes assessed on commissions is not an includable part of the compensation. A copy of the standard agreement is enclosed for your reference.

If I can provide you with any additional information concerning this matter, please do not hesitate to contact me.

Sincerely,

*David R. Murchison*

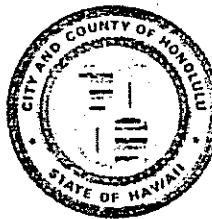
David R. Murchison  
Attorney

Enclosure

## DEPARTMENT OF THE CORPORATION COUNSEL

## CITY AND COUNTY OF HONOLULU

HONOLULU, HAWAII 96813

FRANK F. FASI  
MAYORBARRY CHUNG  
CORPORATION COUNSEL

October 3, 1977

Mr. Samuel B. K. Chang  
Director  
Legislative Reference Bureau  
State of Hawaii  
State Capitol, Room 004  
Honolulu, Hawaii 96813

Dear Mr. Chang:

This is in response to your letter of August 12, 1977 addressed to Mr. Barry Chung, the Corporation Counsel. In that letter, you raised the question of whether or not Revised Ordinances of Honolulu 1969 (RO), Section 12-1.9, the taxicab fare schedule, prohibits taxicab drivers from passing on the State excise tax to their customers.

We answer this question in the affirmative.

RO Section 12-1.9(c) specifically states that "no other charges shall be made for the use of a taxicab for hire except as provided herein." Additionally, Section 12-1.9(a) prohibits the charge of fares other than those pursuant to the schedule in the ordinance and requires that taximeters be adjusted accordingly. It appears from the language of these sections that it was the intent of the City Council to make the ordinance charges complete, inclusive of all costs, and to prohibit any surcharges.

Furthermore, investigation has disclosed that at the present time, the excise tax is not added to the meter rate. There is no evidence that any other practice has ever been followed. If we apply the principle that any ambiguity in an ordinance or statute may be resolved by looking at the long practice of those charged with administering the law, County of Hawaii v. Auditor, 25 Hawaii 372 (1920); Re Sprinkle and Chow Liquor License, 40 Hawaii 485 (1954), it can be seen that the same conclusion is reached.

Mr. Samuel B. K. Chang  
Page 2  
October 3, 1977

Accordingly, we conclude that it is the intent of the City Taxi Control Ordinance to be inclusive of the State excise tax and that it would, therefore, be improper for taxi operators to pass that tax on to their customers by adding it to their meter rates.

Very truly yours,



RICHARD D. WURDEMAN  
Deputy Corporation Counsel

RDW:ct

GEORGE R. ARIYOSHI  
GOVERNOR



GORDON Y.H. WONG  
DIRECTOR OF TAXATION  
STANLEY D. SUYAT  
DEPUTY DIRECTOR

DEPARTMENT OF TAXATION  
STATE OF HAWAII

AUG 9 1977

Honolulu, Hawaii  
August 8, 1977

Mr. Samuel B. K. Chang, Director  
Legislative Reference Bureau  
State Capitol, Room 004  
Honolulu, Hawaii

Dear Mr. Chang:

This is in response to your letter dated August 2, 1977, regarding the five items of information that this office was to provide you not later than August 1, 1977, as per S.R. No. 456, S.D. 1.

The first item, a listing of occupations whose commissions are taxed by the general excise tax, was initially sent on May 31, 1977, to Mr. Lester Ishado of your staff. Since that date, members of my staff discussed with Mr. Ishado by telephone, the other four items. My staff assumed that relaying this information by telephone would suffice. However, from your letter of August 2 and, from a telephone conversation on August 3 Mr. Ishado had with Mr. Harold Lishman of my staff, it appears that if information is submitted orally or if submitted in writing but not on official stationery of the Department of Taxation, it is not acceptable by your office. I regret the inconvenience this procedure may have caused you.

Accordingly, to comply with your request we submit the following in the order requested:

- (1) The list of occupations is attached hereto on a separate letterhead.
- (2) and (3) To the best of our knowledge none of such occupations pass on the tax in the manner it is passed on by licensed sellers of tangible personal property or services. However, an indirect pass-on could be accomplished by increasing the percentage or the amount of the commissions by an amount equal to the tax due on the commission. For example, the commission could be raised from 2% of the

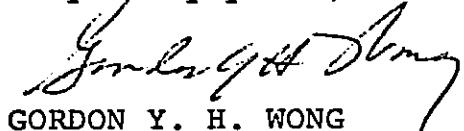
Mr. Samuel B. K. Chang  
Page 2  
August 8, 1977

sales price to 3% and the increased amount of the commission then added to the price of the article being sold.

(4) and (5) For the fiscal year ending June 30, 1976, the State collected \$557,121 from insurance solicitors under the two percent general excise tax provision; and for the same period, the State collected \$6,376,669 from commission income from all sources at the four percent rate. We are not able to segregate commission income earned by insurance general agents or subagents from commission income earned by others.

I trust the foregoing information and the attached listing will assist you in performing your study.

Very truly yours,



GORDON Y. H. WONG  
Director of Taxation

cc: Honorable Richard S. H. Wong

GEORGE R. ARIYOSHI  
GOVERNOR



GORDON Y.H. WONG

DIRECTOR OF TAXATION

STANLEY O. SUYAT

DEPUTY DIRECTOR

DEPARTMENT OF TAXATION

STATE OF HAWAII

P. O. Box 259, 96809

LIST OF COMMISSION OCCUPATIONS FOR SENATE RESOLUTION 456

1. Advertising agencies
2. Appliance salespersons
3. Art galleries
4. Automobile salespersons
5. Barbers
6. Book salespersons
7. Catalog salespersons
8. Cemetery plot salespersons
9. Coin operated machine
10. Collection agencies
11. Encyclopedia salespersons
12. Finders fees
13. Fishermen
14. Fuller brush salespersons
15. Hairdressers
16. Home products salespersons
17. Jewelry salespersons
18. Magazine salespersons
19. Manufacturer's representatives
20. Mortuary salespersons
21. Mutual fund salespersons
22. Pre-cut home salespersons
23. Real estate brokers
24. Securities salespersons
25. Shoe salespersons
26. Taxi drivers
27. Travel agents
28. Vacuum cleaner salespersons
29. Vinyl siding salespersons
30. Wig and other hairpiece salespersons

GEORGE R. ARIYOSHI  
GOVERNOR



WAYNE MINAMI  
DIRECTOR  
BANK EXAMINER  
COMMISSIONER OF SECURITIES  
FIRE MARSHAL  
INSURANCE COMMISSIONER

STATE OF HAWAII  
OFFICE OF THE DIRECTOR  
DEPARTMENT OF REGULATORY AGENCIES

1010 RICHARDS STREET  
P. O. BOX 541  
HONOLULU, HAWAII 96809

E. JOHN MCCONNELL  
DEPUTY DIRECTOR

September 23, 1977

Mr. Lester Ishado  
Researcher  
Legislative Reference Bureau  
State Capitol, Room 004  
Honolulu, Hawaii 96813

Dear Mr. Ishado:

In response to your letter of August 10, 1977, the following information is provided.

With reference to insurance solicitors, subagents and general agents, we enclose a copy of Sections 431-424 and 431-425, Hawaii Revised Statutes. You will note that Section 431-424 provides that the premium stated in the policy must be all-inclusive and prohibits an insurer or any of its representatives from charging any other fee, etc. Section 431-425 prohibits an insurer or any of its representatives from making agreements outside the policy itself. It follows that no general agent subagent or solicitor may legally collect or pass on any excise tax charged against him either by surcharging the stipulated premium or a "side" agreement with the policyholder.

The licensing laws and the rules and regulations for travel agents and real estate brokers are silent on the amount of commission or fees that may be charged a consumer. Also, there is no provision either in the laws or rules pertaining to excise tax. This is also true for automobile salespersons, barbers, cemetery plot salespersons, collection agencies and hairdressers.

Mr. Lester Ishado  
Page 2  
September 23, 1977

There are no provisions in the Sale of Securities Act (Chapter 485, Hawaii Revised Statutes) or in the rules and regulations relating thereto concerning commissions paid to securities salesmen. All persons selling securities are known as "securities salesmen", including persons selling mutual funds exclusively.

We do not regulate taxi drivers. They come under the jurisdiction of the Taxi Control Bureau, Honolulu Police Department, 1455 South Beretania Street.

Please do not hesitate to contact us if we may be of further assistance to you in your study.

Very truly yours,



Wayne Minami  
Director

Attachment

Sec. 431-422

INSURANCE

obligations of the parties to the contract. [L 1955, c 277, pt of §1; RL 1955, §181-422]

§431-423 Charter, bylaw provisions. No policy shall contain any provision purporting to make any portion of the charter, bylaws, or other constituent document of the insurer a part of the contract unless that portion is set forth in full in the policy. Any policy provision in violation of this section shall be invalid. [L 1955, c 277, pt of §1; RL 1955, §181-423]

§431-424 Stated premium must include all charges. (a) The premium stated in the policy shall be inclusive of all fees, charges, premiums, or other consideration charged for the insurance or for the procurement thereof. This subsection shall not apply to surety or group insurance contracts.

(b) No insurer or its officer, employee, agent, solicitor, or other representative shall charge or receive any fee, compensation, or consideration for insurance which is not included in the premium specified in the policy. [L 1955, c 277, pt of §1; RL 1955, §181-424]

§431-425 Must contain entire contract. (a) No agreement in conflict with, modifying, or extending any contract of insurance shall be valid unless in writing and made a part of the policy.

(b) No insurer or its representatives shall make any insurance contract or agreement relative thereto other than as is plainly expressed in the policy.

(c) The requirements of this section shall not apply to the granting of additional benefits to all policyholders of an insurer, or a class or classes of them, which do not require increases in premium rates or reduction or restrictions of coverage. [L 1955, c 277, pt of §1; RL 1955, §181-425]

§431-426. Limiting actions, jurisdictions. (a) No insurance contract delivered or issued for delivery in this State and covering subjects located, resident, or to be performed in this State, shall contain any condition, stipulation, or agreement:

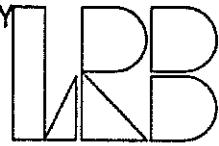
- (1) Requiring it to be construed according to the laws of any state or country except as necessary to meet the requirements of the motor vehicle financial responsibility laws or compulsory disability benefit laws of such other state or country; or
- (2) Depriving the courts of this State of the jurisdiction of action against the insurer; or
- (3) Limiting right of action against the insurer to a period of less than one year from the time when the cause of action accrues in connection with all insurances other than property and marine and transportation insurances. In contracts of property insurance, or of marine and transportation insurance, the limitation shall not be to a period of less than one year from the date of the loss.

(b) Any such condition, stipulation, or agreement in violation of this section shall be void, but such voiding shall not affect the validity

# APPENDIX D

Samuel B. K. Chang  
Director

## FFECTED PARTIES AND AGENCY RESPONSES TO STUDY



C  
O  
P  
Y

LEGISLATIVE REFERENCE BUREAU  
State of Hawaii  
State Capitol  
Honolulu, Hawaii 96813  
Phone 548-6237

September 30, 1977

0578A

Mr. Gordon Wong  
Director  
Department of Taxation  
Hale Auhau  
425 Queen Street  
Honolulu, Hawaii

Dear Mr. Wong:

The Office of the Legislative Reference Bureau was requested to conduct a study of various occupations (especially insurance agents and including, after research, travel agents and taxi drivers) which operate on commissions, are subject to the excise tax, and are statutorily unable to pass the tax on to the customers. Enclosed you will find a copy of the preliminary final draft of the study. We would appreciate any written comments you may have for possible inclusion or use in the study. Since this study is due prior to the 1978 legislative session, we would need to have the written comments before October 28, 1977. Thank you very much for your cooperation.

Please send any written comments to:

Legislative Reference Bureau  
State Capitol, Room 004  
Honolulu, Hawaii 96813

Attention: Lester Ishado

Very truly yours,

Lester Ishado  
Researcher

LI:ck

Enclosure

Similar letter sent to following:

Mr. Gordon Wong  
Director  
Department of Taxation  
Hale Auhau  
425 Queen Street  
Honolulu, Hawaii

Mr. Wayne Minami  
Director  
Department of Regulatory  
Agencies  
1010 Richards Street  
Honolulu, Hawaii

Mr. Mitsuru Fujimoto  
770 Kapiolani Blvd., Suite 614  
Honolulu, Hawaii 96813

Mr. Tommy Lee  
P. O. Box 1096  
Honolulu, Hawaii 96808

Mr. Thomas Anderson  
President  
American Society of Travel Agents  
Hawaii Chapter  
c/o Travel Arrangements, Inc.  
Room 401  
Dillingham Transportation Bldg.  
Honolulu, Hawaii 96813

Manager  
SIDA of Hawaii, Inc.  
P. O. Box 29420  
Honolulu, Hawaii 96820

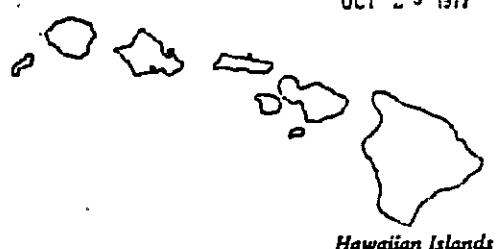
Manager  
Charley's Taxi  
1888 Kalakaua Avenue  
Honolulu, Hawaii 96815

Manager  
Trade Wind Taxi  
1865 Ala Wai Blvd.  
Honolulu, Hawaii 96815

Mr. Ernest H. McCaughan  
Hawaii Insurer's Council  
c/o Pacific Insurance Co.  
P. O. Box 1140  
Honolulu, Hawaii 96807

# HAWAII STATE ASSOCIATION OF LIFE UNDERWRITERS

A Member of the National Association of Life Underwriters — Washington, D.C.



1977-1978

## OFFICERS/BOARD OF DIRECTORS

### *President*

**GARY T. NISHIMOTO**

*Immediate Past President*  
**IMITSURU FUJIMOTO, CLU**

*President-Elect and 1st Vice President*  
**ROY T. YOSHIMURA**

*Vice President (Hilo)*  
**DENNIS ANCHETA**

*Vice President (Honolulu)*  
**ARTHUR K. KUSUMOTO**

*Vice President (Kauai)*  
**VICTOR K. PANNUA, SR.**

*Vice President (Maui)*  
**LOUIS FERNANDEZ, JR.**

*Secretary*  
**SHIGEO OZAKI**

*Treasurer*  
**HENRY T. DUHAYLONGSOD**

*National Committeeman*  
**KENNETH KOSEKI**

## STATE COMMITTEEMEN

*Hilo*  
**JAMES MAEDA**

*Honolulu*  
**DEAN C. SCHRADER**

*Kauai*  
**TEOFILO P. TACBIAN**

*Maui*  
**TAKAYUKI HARADA**

## COMMITTEE CHAIRMEN

*Convention*  
**ARTHUR K. KUSUMOTO**

*Ethics*  
**GEORGE S. NAGAI**

*Education & Training*  
**JAMES M. HAMADA, CLU**

*Finance*  
**FREDERICK K. TSEU, CLU**

*Health Insurance Activities*  
**IWAO YAMASAKI, CLU**

*Company-Field Communications*  
**DANIEL LAU**

*Legislation*  
**IMITSURU FUJIMOTO, CLU**

*Membership*  
**MICHAEL Y. SUENAGA**

*Public Relations*  
**KENNETH K. ALFORD**

*Public Service*  
**THEODORE K. AWAYA**

*Recognition of Quality & Achievement*  
**KENNETH R. JILLSON, CLU**

*Sales Congress*  
**RICHARD M. HIGUCHI, CLU**

October 20, 1977

Mr. Lester Ishado, Researcher  
Legislative Reference Bureau  
State Capitol, Room 004  
Honolulu, Hawaii 96813

Dear Mr. Ishado:

May I take this opportunity to thank you for letting us respond and provide input into the several recommendations that have been developed on the study requested by Senate Resolution 456.

All indications point to a very objective, comprehensive and detailed investigation of the pertinent points.

We are submitting further information, which we feel may be helpful in clarifying your recommendations.

Sincerely yours,

Mitsuru Fujimoto, C.L.U.  
HSALU Legislative Chairman

MF:fi



## MEMBER ASSOCIATIONS

HILo ASSOCIATION OF LIFE UNDERWRITERS • HONOLULU ASSOCIATION OF LIFE UNDERWRITERS • KAUAI ASSOCIATION OF LIFE UNDERWRITERS  
MAUI ASSOCIATION OF LIFE UNDERWRITERS

The question being posed is: What are the implications of charging 4% gross excise tax on the commissions of the solicitor and overwrites of the sub-agent and general agents, which is passed on to the purchaser of the insurance policy.

A first glance does not seem to pose much problems with such an approach. An insurance solicitor submits an application, the company approves the application or rejects the application. If it approves, a policy is issued and the insured pays a premium on which the solicitor receives a commission.

When industry practices are analyzed in the granting of commissions, there appears to be the creation of additional questions which may create serious problems in the implementation of such a recommendation. For purposes of discussion, these fall into three categories. These, however, are by no means, all of the points as company practices vary.

1. Commissions or expense of issuing policy charged back to the solicitor, sub-agent or general agent by the company.

a. Cancellation of life policy within one year may cause charge back of medical expense and other charges which may be equal to more or less than commissions paid on the one particular case.

b. Cancellation of individual policy in a pension plan within one year may cause withdrawal of commissions already paid to the agent on the unearned part of a paid annual premium. Unearned premiums (which may include commissions) may be returned to the Trustee of the plan.

c. Cancellation of property and liability policy within a short period of time after policy is issued, premiums collected, and commissions paid to the agent, which is then taken back by the company.

d. Changing the coverage or the property to be insured during a policy year could mean commissions being reduced to the agent.

e. Change of a life policy to a lower commission type and subsequent charge back to the solicitor of commissions after policy is in force for a while.

2. Contingent commission payment to solicitor and sub-agent and general agent after all premiums are paid for that period.

a. Contingent or bonus commissions may be based on production after one or more years. This may take the form of cash or payment of convention expenses.

b. Persistency commission which is given after one or more years or may be based on persistency requirement for one year and a production requirement extending into the 1st or 2nd quarter of the following years.

c. Prize point which is calculated into commissions for a sales contest period based on production. The amount is not known until the contest ends. All premiums may already have been paid for that policy.

d. Contingent commission based on loss ratio (property and liability), the computation of which may cover one or more years (in one company, three years).

3. Administrative and Accounting problems.

a. Commission amounts for life policy changes two or three times during the first several years. This will create problem of computation for companies and insurance solicitors.

b. The purchaser of insurance may pay premiums through a checking account, which is deducted automatically. The change in commission and as a result, change in 4% general excise tax, will create many problems for the public.

c. Some solicitors in the first few years receive a set amount, a draw against future commissions, or an amount of commission which is based on an annualized premium which is collected monthly. In the case of a lapse, or if the solicitor leaves the business, problems of computation will be involved.

d. Overwrites (commission paid to the general agent and in some cases, the sub-agent), may be dependent on the type and amount of policy and again a contingent commission may be paid at the end of the year after all premiums are paid, based on volume production or previous production. The insurance solicitor may have difficulty trying to compute the total of commissions and overwrite in order to calculate the 4% general excise tax.

e. If a policyholder moves to another state or country, would the 4% tax on the commissions still apply?

f. Commissions for different contracts, e.g., broker, part-time agent, career agent may differ depending upon whom they deal with, whether the contract is with a general agent, sub-agent, or direct with the insurance company's home office. In applying the 4% general excise tax, the overwrites of the general agent or sub-agent must also be included in that figure which is used in the computation.

g. Expense allowance for general agents may be computed at the end of the year, based on production for that year.

What are the implications of allowing the insurance solicitor, sub-agent and general agent to pay .015 percent of commissions received. This is now the practice and which is paid by those who pass on the tax. The statement is made in Alternative IIC—Reduction in Rates III-9 that if a .015 percent rate is set for the entire industry and cannot be passed on, insurance agents are not faced with the competitive decision of passing or not passing on the tax.

Please note that there actually already would be a competitive edge by those companies such as All State and Liberty Mutual and others who choose to provide compensation in other forms than straight commissions and would not be subject to the general excise tax. In addition, the so-called direct writers of insurance generally charge a lower premium compared to other companies.

That there would be a reduction in general excise taxes collected, if the excise tax is reduced to that comparable to those who pass on the general excise tax has been one of the deterrents to implementing a recommendation like this.

Many insurance underwriters have expressed the opinion that the tax, even at 2% for solicitors and 4% for sub-agents and general agents, should not have been collected and this has been extra revenue to the State of Hawaii for at least twenty years. Those who argue that the State would lose revenue on one hand have not examined what comes in on the other hand through increased income taxes from a higher income tax base from solicitors and others connected with the insurance company.

The above notwithstanding, several suggestions have been made to make up for the loss of revenue. These are:

1. Increase premium taxes for property and liability insurance. Primary reason for this is that property and liability insurance are short term contracts, lasting one year on the average and not more than three years. Life policies may continue for periods up to and beyond 50 years with return of cash value equaling the face amount, if continued for the length of the policy period.
2. Increase license and exam fees to cover part of the cost. In the past, testimony has been put forth agreeing to this.
3. Already implemented is the practice of the State of Hawaii to collect premium taxes from an annual basis to monthly basis. The early collection of premium itself brings in approximately \$350,000 interest income from funds left at lending institutions. The above figure is based on 6% interest rate on premium taxes collected in 1975. Insurance representatives did not actively oppose this measure.
4. The Ninth Legislative Session of the State of Hawaii passed into law a bill which now allows the purchase of any amount of group life insurance. The maximum up to June 1977 was \$50,000. The potential premium taxes to be collected once insurance companies begin to actively promote increased amounts of group insurance is not predictable at this time, although the amount should be substantial. In the past, group insurance for large amounts were purchased out of state.

# SIDA

OF HAWAII, INC.

P. O. BOX 9457 / HONOLULU, HAWAII 96820 / PHONE 841-6003

November 8, 1977

Legislative Reference Bureau  
State Capitol, Room 004  
Honolulu, HI 96813

Attention Mr. Lester Ishado

Gentlemen:

This is a belated reply to your letter of September 30, 1977. We appreciate the opportunity to review your study on various occupations that are statutorily unable to pass on the general excise tax. What was pointed out in your study regarding the interpretation, because of the City ordinance regulating taxi fees, is correct. It is also true that some taxi drivers may not be able to pass on the tax as a practical matter because of the complication of explaining the difference between the amount shown on the taxi meter and the additional 4% that would be charged. This is particularly true because of the number of tourists who use taxicabs.

It is felt that if the taxi drivers were able to obtain an option of passing on the tax to customers, this would be more equitable. Drivers who wish to pass on the tax could do so and it is possible that a more sophisticated meter may be able to compute the tax.

Another possibility we wish to raise is that since our taxi meter fares are regulated and since the industry serves a necessary public transportation function, that there is a public policy in favor of encouraging the taxi industry that could or should be reflected in either the elimination of the general excise tax with respect to this industry or the reduction of the tax.

Very truly yours,  
SIDA OF HAWAII, INC.  
By \_\_\_\_\_  
Its General Manager

css

# HAWAII INSURANCE ASSOCIATION

SUITE 906 • HAWAII BUILDING • 745 FORT STREET • HONOLULU, HAWAII 96813  
TELEPHONE 531-3125

HARRY G. ALBRIGHT  
Executive Vice President

November 11, 1977

Dr. Samuel B. K. Chang, Director  
Legislative Reference Bureau  
State of Hawaii  
State Capitol, Room 004  
Honolulu, Hawaii 96813

Dear Dr. Chang:

The Hawaii Insurance Association appreciates this opportunity to comment on the preliminary draft of the Legislative Reference Bureau's report: A Study of Hawaii's General Excise Tax on Commissions.

In our opinion the study is objective and fully discusses the issues relevant to the general excise tax on insurance commissions. We specifically note that the study does recognize that the present system, with regards to insurance agents, is inequitable because:

"...insurance solicitors, general agents, and subagents who are in an independent contractor status are prohibited by section 431-424, Hawaii Revised Statutes, from passing on the excise tax to the clients. The insurance company and its agents are prohibited by this section from charging any fee, compensation, or consideration for insurance which is not included in the premium specified in the policy which premium must be approved by the insurance commissioner. The premium stated in the policy must be inclusive of all fees, charges, premiums, or other consideration. It should be noted that section 431-424, Hawaii Revised Statutes, does not prohibit the excise tax from being indirectly passed on to the customer by being included in the premium." (p. II-3)

Furthermore, as the study notes, insurance agents are in fact bearing a tax burden of 4 or 2 per cent while the actual tax borne by taxpayers throughout the State who can pass on the excise tax, is but .15 per cent. (p. III-4 and 5)

The Hawaii Insurance Association believes that Recommendation I: Allow Agents to Pass On Tax (p. III-11) which would allow insurance agents to pass on the general excise tax to customers, while correct in principle, would prove to be costly, complicated, and very difficult of administration by both the State and the insurance industry.

This is so because of the differences in commission structure and billing systems currently used in servicing the many different lines of insurance offered and purchased in Hawaii, and also because of the complications that would be posed by the record keeping and collection requirements of proposed Recommendation I.

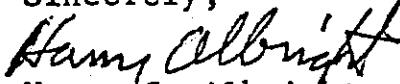
The Hawaii Insurance Association believes the Alternative Recommendation: Reduce Tax Rates (p. III-14) which would reduce the excise tax rate for insurance agents to .15 per cent would provide a simpler and more efficient method of levying this tax. By setting the tax rate at this level, the State would be treating insurance agents equitably as compared with other commission-based occupations. The Alternative Recommendation would afford both ease of compliance by the taxpayer, and simplify the administration of the tax by the State. In addition, this proposal would require far fewer statutory amendments than Recommendation I.

We are aware that such a rate reduction would result in a loss of State revenues upwards of \$500,000 annually. However, we are in accord with the Study's suggestion (p. III-15) that the insurance premium tax set forth in Section 431-318, HRS, be adjusted to compensate for any revenue loss. In this regard, we suggest an actuarial estimate of the potential revenue loss be made until such time that the Department of Taxation can provide specific figures for excise tax revenues on the commissions of insurance agents. The State would then know precisely the adjustment required for the insurance premium tax.

We also call attention to the fact that because of the continuing growth of the insurance industry, the State enjoys a corresponding growth in tax revenues. Thus, even a revenue loss resulting from an excise tax reduction would be more than made up through increased volume without raising the insurance premium tax.

We commend the Legislative Reference Bureau on this Study of insurance taxation which provides a fair and informed analysis of a difficult problem. We hope our comments will be of benefit and we stand ready at your call to assist you further in this matter.

Sincerely,



Harry G. Albright  
Executive Vice President

HGA:si

GEORGE R. ARIYOSHI  
GOVERNOR



WAYNE MINAMI  
DIRECTOR  
BANK EXAMINER  
COMMISSIONER OF SECURITIES  
FIRE MARSHAL  
INSURANCE COMMISSIONER

E. JOHN MCCONNELL  
DEPUTY DIRECTOR

STATE OF HAWAII  
OFFICE OF THE DIRECTOR  
DEPARTMENT OF REGULATORY AGENCIES

1010 RICHARDS STREET  
P. O. BOX 541  
HONOLULU, HAWAII 96809

November 25, 1977

Mr. Lester Ishado  
Researcher  
Legislative Reference Bureau  
State Capitol, Room 004  
Honolulu, Hawaii 96813

Dear Mr. Ishado:

We have received your preliminary draft of "A Study of Hawaii's General Excise Tax on Commissions" and offer the following comments:

1. The scope of this study is unduly narrow. It states "The issue is whether the taxpayer is able to pass the excise tax on to the customer." (p. I-2) It answers with a simple "No." (p. II-3) After examining other occupations that operate on a commission basis, the Bureau recommends that insurance agents be allowed to pass on the excise tax because "it would be equitable to do so." (p. III-13)

We believe that equity to the taxpayer is but one issue which should be addressed when making recommendations to the Legislature. Other issues which should be considered are:

- a. Insurance companies are aware that the agent cannot pass on the tax. Is that fact taken into consideration when commission rates are set? If the answer is "Yes", passing on the excise tax amounts to an unreasonable burden on the insurance consumer.
- b. Insurance premium rates have been a matter of great concern to the Legislature. Rates of all casualty insurance, excluding auto,

Mr. Lester Ishado  
Page 2  
November 25, 1977

are regulated by the insurance commissioner. Section 431-424 is an essential part of this mechanism because it assures that the price paid by the consumer is in fact the price approved by the department. The Bureau's recommendation erodes this safeguard for the consumer without adequate explanation.

2. Not all insurance premiums are regulated and approved by the insurance commissioner. The most significant kinds of insurance exempt from rate regulations are life and disability (accident and health), except credit life and disability. The rate structures for these kinds of insurance contemplate mortality or morbidity costs, expenses including commissions to agents, premium taxes, and interest earnings. The commission allowance to agents should take into consideration the expenses of the agents, including the excise tax that must be paid by the independent-contractor agents. Notwithstanding the fact that the rates are unregulated, life insurance rates of an insurance company are generally uniform regardless of the State in which the insurance is purchased. Prudential Insurance Company of America, for example, will not publish a rate book which would be applicable only in Hawaii.
3. The study does not address the unique characteristics of a commission salesman, as seen by the following:

- a. The report assumes other occupations are permitted to and do pass on the tax. This is not true in many instances.

For example, when a vacuum cleaner salesman sells a vacuum cleaner priced at \$300, he would collect \$12 ( $\$300 \times .04 = \$12$ ) in tax from the customer. Assuming he receives a commission of \$60 and his sales representative receives \$10, the total tax liability for both of them will be \$14.80 ( $\$300 \times .04 = \$12$ ;  $\$10 \times .04 = 40\%$ ;  $\$60 \times .04 = \$2.40$ ).

Mr. Lester Ishado  
Page 3  
November 25, 1977

As the salesman collected only \$12 in tax from the customer, it must be apportioned among them. If the company has the bargaining power it may collect the \$12 and apply it to its tax liability. The balance of \$2.80 would have to be absorbed by the salesman and the sales representative in that case. If, however, the salesman has the bargaining power, he can claim his total tax liability. In this example, tax burden is determined by bargaining power of the parties, a factor which the Bureau dismisses in the insurance area. (p. III-6)

- b. Applying the same facts for an insurance policy with a \$300 yearly premium, the consumer would pay \$300 for the policy plus \$2.40 for taxes. In order to meaningfully explain the \$2.40 tax, the agent will have to disclose his commission of \$60 for the sale.
- c. The Bureau states "It is furthermore economically unrealistic to expect insurance agents to possess sufficient bargaining position to force the insurance companies to reduce the companies' profit in order to cover the agents' payment of the excise tax." (p. III-7) That statement may be true in certain lines. In other lines, compensations to agents are negotiated. In other words, a good agent can get incentive bonus not available to other agents. The bonus is considered additional commission. In some lines, insurance companies compete for business by varying the amount of agent's commission. Thus, the Bureau's statement should be reviewed.

4. The passing on of the agent's excise tax liability presents practical problems:

- a. The question arises as to who will be responsible for refunding the excise tax collected when an insurance policy is cancelled in mid-term. For example, an individual purchasing an automobile

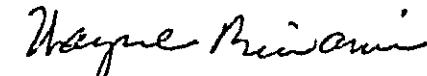
Mr. Lester Ishado  
Page 4  
November 25, 1977

insurance policy pays an annual premium of \$300. The general agent receives a commission of \$30; the solicitor, \$40. The total excise tax to be passed on will be \$3. ( $\$30 \times .04 = \$1.20$ ;  $\$40 \times .04 = \$1.80$ ) If the policyholder cancels this policy six months after the expiration date, he will receive a short-rate premium refund of \$120. Who will be responsible for refunding the short-rate tax refund of \$1.20 to the policyholder? Will the general agent be required to refund 48¢ and the solicitor 72¢, or would the insurance company be responsible for refunding the \$1.20? Regardless of who is responsible, it is evident that the expense of processing these small refunds could be very costly and probably would be passed on to the policyholders.

b. Some companies employ employees to sell insurance. Since no excise tax is applicable to them, they may have a competitive edge over companies using commissioned salesmen.

I shall be happy to discuss the foregoing comments with you.

Very truly yours,



Wayne Minami  
Director