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March 28, 2008

TO: Senator Rosalyn Baker  
Chair, Senate Committee on Ways & Means  
Hawaii State Capitol, Room 210  
Via Email: testimony@capitol.hawaii.gov

FROM: Chris Pablo

RE: **H.B. No. 2306 HD2 SD2– Relating to General Excise Taxation**  
**Hearing on Friday, March 28, 2008 at 9:30 am, Room 211**

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Dear Chair Fukunaga and Members of the Committee on Health:

I am Chris Pablo testifying on behalf of TriWest Healthcare Alliance Inc. ("TriWest"), a Delaware corporation headquartered in Phoenix, Arizona. **TriWest supports HB 2306 HD2 SD2.**

TriWest is one of several regional third-party administrators or fiscal intermediaries of a cost-effective, high quality network of health care providers for the nation's active and retired uniformed service members and their families, under a federal government program known as "TRICARE" and formerly known as "CHAMPUS."

**What is TRICARE?** The Federal Government has established a managed health care program for members of the uniformed services and certain dependents. It was created in the early 1990s to supplement the existing military health care delivery system and provide health care services for active duty military personnel, military retirees, and their families (collectively, the "Beneficiaries") by utilizing civilian health care providers.

In Hawaii, the Beneficiaries have access to the military health care facilities, such as the Tripler Army Medical Center and to health care clinics on military bases through the state. In addition, the Beneficiaries have access to medical services through the network of community health care providers that has been created by TriWest.

TRICARE receives its funding as part of the annual defense appropriations budget. It is administered by the TRICARE Management Activity ("TMA"), which is part of the United States Department of Defense ("DoD"), Office of the Assistant Secretary of Defense (Health Affairs).

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**What is TriWest?** In the health care industry, TriWest's business would be characterized as a "**third-party administrator**." TriWest, known as a "**managed care support contractor**" in the applicable Federal laws and regulations, is a disbursing agent for the Federal Government in the western states, including Hawaii. Its job is to receive claims and invoices from health care providers, and then pay those claims according to the amounts and guidelines set by the Government ("**reimbursement**"). The Government then reimburses TriWest for the amounts paid, and also pays TriWest an **administrative fee** for its services. This is best illustrated in the attached PowerPoint slide.

TriWest pays Hawaii General Excise Tax on the amounts it receives from TRICARE as compensation for its services as *managed care contractor*, but it does not pay tax on the reimbursement amounts. In prior discussion with representatives of the Department of Taxation, there was some concern that the reimbursement amounts might be taxable. If they are taxable, the costs for health care of uniformed service members would increase significantly. TriWest is asking the Department of Taxation for formal clarification of this issue, and is concurrently asking the Legislature for similar relief.

**What is the purpose of HB 2306 HD2 SD2?** The purpose of HB 2306 HD2 SD1 is to make clear that the amounts received by TriWest from TRICARE as "reimbursements" are exempt from the imposition of the General Excise Tax by amending Section 237-24.75 by adding a new subsection (3). The proposed subsection (3) will read, as follows:

"Amounts received by a managed care support contractor of the TRICARE program that is established under 10 United States Code chapter 55, *as amended*, for reimbursement of costs or advances made pursuant to a contract with the United States; and"

**Why is the effective date retroactive to January 1, 2005?**

To date, TriWest, as well as the predecessor TRICARE administrator in Hawaii, have paid GET on the administrative fees allocable to Hawaii and have never been assessed on the "reimbursements." This bill clarifies that the status quo is correct, so there should be no revenue impact to the State from passage of this bill.

Section 4 of HB 2306 HD2 SD2 contains a retroactive effective date of January 1, 2005 because the statute of limitations has run on any assessments for periods prior to January 1, 2005 and TriWest wants to be assured that the exemption contained in HB 2306 HD2 SD2 is intended by the legislature to apply to all "reimbursements" that TriWest has received from TRICOR since the inception of its present contract.

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We urge your committee to pass this bill unamended to the full Senate for Third Reading. We thank you for the opportunity to testify in support of HB 2306 HD2 SD2.

# TAXBILLSERVICE

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**SUBJECT:** GENERAL EXCISE, Exempt reimbursements for TRICARE program

**BILL NUMBER:** HB 2306, SD-2

**INTRODUCED BY:** Senate Committee on Economic Development and Taxation

**BRIEF SUMMARY:** Amends HRS section 237-24.75 to clarify that amounts received by a managed care support contractor of the TRICARE program established under the 10 United States Code chapter 55 for reimbursement of costs or advances made to health care providers pursuant to a contract with the United States shall be exempt from general excise taxation.

**EFFECTIVE DATE:** Retroactive to January 1, 2005

**STAFF COMMENTS:** The TRICARE program was established by the U.S. Department of Defense (DOD) as the managed care component of the Military Health Care system to augment the health care services provided to DOD personnel at military treatment facilities. TRICARE contracts with third-party administrators (managed care support contractors) to establish and maintain networks of TRICARE-authorized civilian health care providers. These managed care support contractors make advances to health care providers for the services they provide to TRICARE beneficiaries and are reimbursed by the DOD for the amounts of such advances.

This measure clarifies that amounts received by the managed care support contractors as reimbursements from the DOD for advances they made on behalf of the DOD for TRICARE program purposes are not taxable under Hawaii's general excise tax law.

While an understanding of HRS section 237-20 which delineates the cost reimbursement provision under the general excise tax law appears to dictate that such reimbursements are not taxable unless the person making the advance receives additional monetary consideration for the services provided, the adoption of this measure may be unnecessary.

On the other hand, if the third party administrator receives a fee for handling these reimbursements, then it runs into the ban that HRS 237-20 imposes where the fee taints the entire amount received from the DOD. Hawaii law has already set precedent, providing that amounts received as reimbursements for wages, salaries and benefits of hotel workers paid by a hotel operator on behalf of the hotel owner are exempt as are reimbursements made on behalf of the city for the operations of the city's bus system by a third-party operator even though additional consideration is received in both cases. It should be noted that the fee paid to the third party administrator would continue to be subject to the general excise tax as the fee is gross income to the third party administrator.

Digested 3/27/08

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## SENATE COMMITTEE ON WAYS & MEANS

### TESTIMONY REGARDING HB 2306 HD 2 SD 2 RELATING TO GENERAL EXCISE TAX

**TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)**

**DATE: MARCH 28, 2008**

**TIME: 9:30AM**

**ROOM: 211**

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This legislation provides a general excise tax exemption for managed care support contractors of the TRICARE program that is established under 10 United States Code chapter 55.

The House Committee on Public Safety & Military Affairs amended the measure to clarify that the exemption applies to reimbursements.

The House Committee on Finance amended the measure's effective date.

The House of Representatives passed this measure on third reading.

The Senate Committee on Health amended the measure by making its effective date retroactive.

The Senate Committee on Economic Development & Taxation made nonsubstantive amendments to the measure.

The Department of Taxation has no comments on this legislation other than citing that this was not factored into the Executive Budget or any of its fiscal priorities this session.

Because this measure was amended to provide retroactive tax relief for any contractors that participate in the TRICARE program, the Department is precluded from providing a specific estimate because of the limited taxpayer population of which the Department utilizes to arrive at its revenue estimates. The Department suggests that the Committee determine the revenue loss of any proposed retroactive tax relief by discussing the matter directly with taxpayers that will benefit from the measure.