The case for exempting medical services from Hawaii's general excise tax

Exempting private practice physicians from the state GET would help alleviate the state's critical shortage of doctors

By Malia Hill
Executive summary

Hawaii policymakers seeking to solve the state’s acute physician shortage must address the financial barriers that make it more difficult for private medical practitioners to thrive in Hawaii.

In particular, they should lighten the tax burden on Hawaii doctors, especially regarding the state general excise tax.

A medical services exemption from the state GET would cost the state an estimated $222 million in lost tax revenues annually. However, since the state has a $2.6 billion surplus for fiscal year 2023 and is expecting a surplus of about $10 billion over the next four years, it is in an excellent position to afford such a tax exemption.

In addition, to the extent that the exemption would help resolve Hawaii’s doctor shortage, the $222 million could be considered money well spent.
Introduction

The coronavirus pandemic and subsequent lockdowns exposed long-standing weaknesses in Hawaii’s healthcare system.

Even now, after the height of the crisis has passed, Hawaii residents are struggling to cope with the stresses brought on by a lack of sufficient medical personnel. Programs that encourage doctors and nurses to work in Hawaii have been helpful. But it is critical that we look more closely at eliminating the burdens that are driving medical professionals away from the state, especially those that raise costs for both patients and providers, such as the state general excise tax.

The declining number of Hawaii healthcare workers is not a new problem, nor is it one that can be blamed on the pandemic. Indeed, healthcare advocates have been tracking the state’s worsening physician shortage for years.

The Hawaii Physician Workforce Assessment Project, in its annual report to the 2023 state Legislature, estimated that when geography and specialist needs are taken into account, Hawaii has an unmet need of 776 full-time-equivalent physicians.¹ The greatest area of need is in primary care with the project estimating that 162 primary care physicians are needed across the state but there are also significant shortages in specialty care.

The worst specialty care shortages are in the areas of pediatric gastroenterology, colorectal surgery, adult and pediatric pulmonology and pediatric endocrinology.

With 100% meaning the specialty is fully staffed, pediatric gastroenterology is short by 69.5%; colorectal surgery is short by 60%; adult and pediatric pulmonary are short by 65.4% and 75.8%, respectively; and pediatric endocrinology is short by 67.9%.²

According to the report, factors contributing to the doctor shortage range from physicians retiring to long work hours and burnout.³

The state has implemented measures intended to attract more physicians, such as recruitment efforts, loan repayment programs and scholarships that would bring new doctors to Hawaii after graduation. However, one strategy for attracting and retaining doctors remains unexplored: Make it more profitable to be a doctor in Hawaii.
The decline in the number of Hawaii healthcare workers is not a new problem, nor is it one that can be blamed on the pandemic.
Hawaii’s general excise tax

Hawaii is one of only two states with a broad tax on delivery of medical services, and the only state that taxes medical services for TRICARE and Medicare beneficiaries.⁴

Not-for-profit facilities such as hospitals are exempt from the state’s GET, but private practice physicians must pay the 4% base state excise tax plus any county surcharges, which are currently capped at 0.5%.

Because the excise tax is a gross receipts tax, it becomes a significant overhead expense for private practice physicians that makes it extremely difficult to turn a profit – especially for new doctors who are just starting out and still paying their student loans.

How much of an economic burden is the state general excise tax for Hawaii doctors?

According to a 2020 report from the Grassroot Institute of Hawaii, for-profit healthcare spending in Hawaii totals approximately $5 billion, with the excise tax accounting for about $222 million of that total.⁵

If all for-profit medical providers were exempted from the general excise tax, it would result in a savings of $200.3 million. That’s about $5,275 per medical worker in the state, or roughly 6.7% of the average medical worker’s wage.⁶

In a state where the cost of living is a major factor in attracting and retaining healthcare personnel, even that small amount could make a difference.

During the 2020 legislative session – which was cut short by the pandemic and lock downs – the Hawaii Legislature considered multiple bills that
would exempt medical services from the general excise tax. The proposed exemption received wide support from the medical community, which cited the tax as a burden on local practices and a contributor to the state’s physician shortage.

In testimony submitted by the Hawaii Medical Association regarding SB2542, Dr. Elizabeth A. Ignacio and HMA Executive Director Christopher Flanders noted that since “roughly 65% of gross revenue collections go to paying overhead, the 4.5% GET accounts for an additional 13% on a physician net practice revenue. This can essentially eliminate the ability to maintain a viable practice, particularly in rural areas with a high proportion of Medicare and Medicaid, the GET costs of which cannot be passed on to patients.”

Even medical personnel who would not have been directly affected by SB2542, such as hospital surgeons, testified that the GET on medical services contributes to the physician shortage, makes it difficult for them to refer patients to other doctors and results in worsening health outcomes for Hawaii residents.

One letter, signed by 50 independent physicians from Hawaii island, stated:

The increasing GET and County surcharges are stripping away the small profit margins for our private medical practices. This has contributed to our severe doctor shortage compounded by the fact that Hawai’i has the lowest percentage of providers accepting Medicare in all 50 states. Hawai’i has a larger percentage of providers in private practices in the nation, and it is important that the private practice of medicine remain sustainable for our ‘ohana. Almost all of our member physicians on Hawai’i Island are small, independent private clinics. Our community risks losing these physicians as their operations become financially unsustainable.
You can’t pass it on — or can you?

One point of confusion about the state GET is whether doctors are permitted to pass on the excise tax to their patients.

The state Department of Taxation has published guidance stating that Medicare, Medicaid and TRICARE patients can be charged for their share of the GET. However, Hawaii doctors say the department is giving erroneous and possibly illegal advice.

Specifically, in a document titled “Tax Facts 98-1,” which purports to answer common questions from patients about the GET charges on medical and dental services, the department responds to a question about whether these federal medical insurance programs are subject to the GET with the following statement:

Yes. The amounts the physician receives from Medicare, Medicaid and/or TRICARE are subject to GET. The physician may charge you GET on these amounts as a way to recover their expense.¹⁰

Notwithstanding that department opinion, Hawaii doctors are concerned that separately billing Medicare patients could be considered “balance billing,”¹¹ which is forbidden for physicians working with Medicare.

Moreover, guidance from Health Net Federal Services, which administers TRICARE in Hawaii, states unequivocally that providers may not pass the GET on to TRICARE beneficiaries, and that the GET is not separately reimbursable by TRICARE.¹²

Although Hawaii law does not prohibit providers from charging patients the GET, per TRICARE regulations and HNFS’ network and non-network provider participation agreements, providers must accept payment from HNFS as payment in full for covered services and may not collect anything from beneficiaries other than statutorily authorized copayments, cost-shares or deductibles.

According to a representative of the Hawaii Physician Shortage Crisis Task Force, doctors have been informed that trying to bill Medicare patients separately for the GET will result in legal action against them.

A formal letter to the task force from the San Francisco regional office of the Centers for Medicare & Medicaid Services referenced federal regulations that prohibit charging Medicare beneficiaries more than the coinsurance and deductible for covered services.
The letter also referenced a similar question from a doctor in another state, emphasizing that additional costs cannot be passed on and implying that doing so will result in federal action.

According to the letter:

The Medicare Physician Fee Schedule amounts are calculated in a way that includes the relative administrative costs related to furnishing services. It appears that this physician is billing beneficiaries for administrative overhead and to offset a downward MIPS [merit-based incentive payment system] adjustments. The physician will need to be educated that he cannot charge beneficiaries more than the deductible and coinsurance for Medicare covered services and that he will need to refund the extra administrative fees that were collected from the beneficiaries. The OIG [U.S. Office of the Inspector General] can impose CMPs [civil monetary penalties] for knowing violations of these rules, so the physician should be referred to the OIG if he does not refund/has repeated violations.13

In short, despite the assurances of the state tax department, the state general excise tax cannot be passed on to Medicare and TRICARE beneficiaries. Thus, it becomes a charge against the revenues of the private practice physician who treats those patients.

The simplest solution – and one that accords with a goal of improving healthcare access while lowering costs – is to exempt medical services from the state general excise tax.
Conclusion

Hawaii has an established practice of carving out GET exemptions for certain industries in pursuit of public policy goals. For example, there are currently more than 50 categories that enjoy GET exemptions, including aircraft maintenance, orchard operators and petroleum refiners.¹⁴

Surely, lowering healthcare costs and attracting healthcare workers is as worthy a policy goal as easing the tax burden for orchard operators.

In the end, this is a simple question of economics. By making it more expensive and less profitable to practice medicine in our state, Hawaii policymakers are effectively discouraging doctors from working here.

This reduced the number of specialists available, making it harder to obtain care in rural areas – especially on the neighbor islands – and increasing the cost of healthcare in general.

Eliminating the GET for medical services would not solve all problems associated with healthcare access and affordability in Hawaii, but it would be an important step in addressing the state’s physician shortage and expensive healthcare.

It would demonstrate that policymakers are listening to the needs of the state’s healthcare workers, and that they are taking action at the local level to relieve the burdens associated with practicing medicine in our state.

It is time to turn the lessons of the coronavirus crisis into action. The Hawaii Legislature should finish what it started in 2020 and create a GET exemption for all medical services.
Surely, lowering healthcare costs and attracting more healthcare workers is as worthy a policy goal as easing the tax burden for orchard operators.
Endnotes

2 Ibid, p. 2.
3 Ibid, p. 16.
4 James R. Dumler, “Where and When are Medical Services Taxable?” McClellan Davis LLC website, accessed Nov. 29, 2022.
6 Ibid,” p. 2.
14 “Hawaii General Excise & Use Tax Exemptions: Tax Year 2021” Hawaii Department of Taxation, November 2022, Table 1, p. 3.