

**S J R**

**41**

SENATE COMMITTEE REPORT

FIRST COMMITTEE OF REFERRAL

Date of 5-DAY NOTICE 4/13/89  
IN ACCORDANCE WITH UNIFORM RULE 23

FURTHER

\*\*FISCAL NOTE(S) MUST BE ATTACHED  
IN ACCORDANCE WITH AS 24.08.035

DATE TURNED INTO OFFICE 4/14/89

4/3/89

Mr. President:

L&C

Committee considered

SJR 41

Supporting the status of the Medical Indemnity Corporation of Alaska as a public corporation and an essential instrumentality of the state and endorsing the corporation's tax exempt status

and recommended:

replace with CS \_\_\_\_\_  same title

attached amendment(s) and  new title

\_\_\_\_\_ letter of intent adopted

do pass

do not pass

no recommendation

individual recommendations

further referral to \_\_\_\_\_

FISCAL NOTE(S) attached Dept of Commerce 4/4/89  zero  fiscal impact  
 appropriation no FN attached  Gov. FN introduced w/ bill

MEMBERS SIGNING DO PASS

OTHER RECOMMENDATIONS

[Signature]  
[Signature]  
[Signature]

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

[Signature]  
Chair : signature and recommendation

Committee backup attached

FISCAL NOTE

REQUEST:

Revision Date: \_\_\_\_\_ Agency Affected: Commerce & Economic Dev.  
 Title: Supporting MICA as a public corporation endoring MICA's tax exempt status Medical Indemnity Corporation  
of Alaska  
 Sponsor: Sturgulewski. Components: \_\_\_\_\_  
 Requester: Senate Labor & Commerce

EXPENDITURES / REVENUES : (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0

CAPITAL	0	0	0	0	0	0
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REVENUE	0	0	0	0	0	0
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FUNDING: (Thousands of dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary.)

Prepared by: Paul Roller, Director  
 Division: Insurance

Phone: 465-2515  
 Date: 4-4-89

Approved by Commissioner: Larry Mercurieff  
 Agency: Department of Commerce & Economic Development

Phone: 465-2500  
 Date: 4/4/89

Distribution (by preparer):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

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MEDICAL INDEMNITY CORPORATION OF ALASKA

TAX ISSUE--BACKGROUND SUMMARY

March 22, 1989

The Medical Indemnity Corporation of Alaska ("MICA") was established by the Alaska Legislature in 1976 to deal with the medical malpractice insurance crisis that existed in Alaska. See AS 21.88.010-21.88.900. At that time all major providers of medical malpractice insurance had withdrawn from the Alaska market. In order to prevent the shortage of physicians that was anticipated to result from the unavailability of malpractice insurance, the Legislature created MICA as a "public corporation" to make available the necessary insurance coverage.

MICA is governed by a nine-member Board of Governors, whose members are appointed by the Governor and confirmed by the Legislature. Initial funding for MICA was provided by the State through the establishment of a \$6,000,000 revolving loan fund, from which MICA may borrow funds upon certification by the Director of Insurance that such a loan is necessary. MICA currently has two outstanding loans from the fund, and these loans are being repaid on the statutory payment schedules. A \$3,000,000 capital loan has now been reduced to \$2.4 million; a \$2,000,000 loan, obtained in 1986 to compensate for fluctuations in loss experience, has now been reduced to \$1.2 million.

In 1977, shortly after MICA was established, MICA sought and obtained from the Alaska Department of Revenue a ruling that MICA was an instrumentality of the State of Alaska and was therefore exempt from state income tax and exempt from the state business license tax. In 1977, MICA also obtained from its independent auditors a written opinion that, as an instrumentality of the State, MICA was exempt from federal income tax under section 115 of the Internal Revenue Code and was not required to file tax returns. Accordingly, MICA has not paid taxes, has not filed tax returns, and has operated in all respects as a tax-exempt instrumentality of the State of Alaska.

In 1988, MICA's independent auditors raised some questions about MICA's exemption from federal income tax. These questions arose in part as a result of changes that were made in the law by the Tax Reform Act of 1986 and by the discovery of some rulings issued by the Internal Revenue Service with respect to other similar but not identical state-established

insurance corporations. In August 1988, through its auditors, MICA requested a ruling from the Internal Revenue Service "with respect to whether the income of MICA is excludable from gross income under Section 115(1) of the Internal Revenue Code of 1986." MICA has not yet received a ruling. It is MICA's understanding that the ruling has not yet been issued, in part, because at the present time there is a division of opinion within the Internal Revenue Service on whether MICA satisfies the requirements for an exemption under section 115(1).

In order for MICA's income to be exempt under section 115(1), the income (1) must be derived from the exercise of an essential governmental function and (2) must accrue to a state or a political subdivision of a state. It is MICA's understanding that the Internal Revenue Service in this case is principally concerned with whether MICA's income accrues to the State, not with whether MICA is performing an essential governmental function. In fact, MICA does satisfy the requirements of section 115(1). Since MICA is an instrumentality of the State of Alaska, all of MICA's income accrues to the State. MICA's income historically has been used only for the necessary expenses of performing MICA's statutory functions and for making the required loan payments to the State.

An attempt by the Internal Revenue Service to tax MICA would raise serious constitutional questions and would extend the issue beyond merely interpreting section 115(1). Under the constitutional principle of intergovernmental tax immunity, the federal government may not impose an income tax on an instrumentality of a state. A ruling by the Internal Revenue Service that it has the authority to impose an income tax on MICA would have serious implications for the tax status of other public corporations that are instrumentalities of the State of Alaska. For example, even the tax-exempt status of the Alaska Permanent Fund would be subject to question. In order to reinforce its position on this question, MICA therefore is seeking the support of the Governor, the Alaska Congressional Delegation, and the Alaska Legislature.

If MICA were found to be subject to federal income tax, its estimated potential tax liability for 1987 and 1988 would total \$2,045,000 (1987--\$1,585,000; 1988--\$460,000). Those taxes would have to be paid out of MICA's existing cash reserves. The taxes for 1989 and future years would have to be funded by premium increases. For 1989, the exact tax liability is not yet known, but MICA's actuaries have calculated that loss of tax-exempt status would require a 1989 premium increase of 12.6 percent for physicians and 10.5 percent for hospitals.