Who is Responsible for the Tax?
A Teaching Case

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This teaching case discusses a specific situation involving an employee, the employer's dental plan, and a dentist. It allows students to consider a unique situation which arose because of misunderstandings of how the Hawaii general excise tax (GET) differs from a sales tax. In addition, taxes, insurance, contracting, and flexible spending accounts are also discussed in general terms. The case is flexible and allows for either basic discussion or critical thinking. It can be used in a variety of business classes.

Key Words: Hawaii General Excise Tax, Sales Tax, Insurance, Flexible Spending Accounts

Introduction

This teaching case offers great flexibility because it can be used in a variety of business courses. It is relevant to accounting, tax, economics, human resource, legal studies, and general business courses.

Forty-four states plus the District of Columbia have sales taxes (http://www.taxadmin.org, 2005).[1] Although Hawaii does not have a state sales tax, it does have a general excise tax (GET) which is often mistaken for a sales tax (State of Hawaii, 2000, 2002). Tax classes often focus on income taxes, but other taxes such as sales, use, excise, and property taxes are very significant to businesses, both in terms of amount and time required for compliance. By discussing the differences between a sales tax and the Hawaii GET, this case can help students learn and think about sales taxes and compare them to another type of tax.

Besides a general discussion of taxes, insurance, and flexible spending accounts, this case includes a specific situation involving a dental patient, his employer, the employer's dental plan, and a dentist. The dollar amount in question in the specific case is very small, but the case requires the students to extrapolate the effects to determine the significance to larger groups. The small amount makes the case interesting to an individual, and the extrapolated amounts make it relevant. Although the fact situation is unique to Hawaii, it is relevant to a wide audience. Students should be exposed to critical thinking situations for unique cases because every state, industry, and business will have unique situations to deal with. In this case, a U.S. mainland insurance company apparently did not fully understand the Hawaii GET but was insuring patients in Hawaii.

Because the case questions are divided into several categories, the instructor can customize the case by assigning only the desired sets of questions. The case can be quite basic, allowing the students to learn the concepts of a sales tax and/or the journal entries for recording sales taxes. Taken further, the case can require much different involvement, allowing the students to reach an evaluative, critical thinking level.

A final section provides notes for teachers. This section includes some guidance on the questions and the real-life conclusion to the situation.

[1]Alaska, Delaware, Montana, New Hampshire, and Oregon have no sales taxes. Hawaii has no sales tax but has a general excise tax instead.

Case Material

Background Information

A company in Hawaii offers an insurance plan to its employees as part of its benefit package. The employer pays 80% of the cost of this benefit which includes a medical plan, a dental plan, group life insurance, disability insurance, and occupational accidental death and dismemberment insurance. Employees are responsible for the other 20% of the cost of the plan. Supplemental insurance products are also available to the employees but must be paid for by the employees. [See Explanation Box 1]

Most of the benefits are managed through a coordinating company, Benefit Coordinating Company (BCC)[2], set up to administer benefits for multiple affiliated employers. Most of these employers are located on the U.S. mainland. Up through 1998, BCC administered its own dental insurance plan. However, starting in January 1999, a large national insurance company, National Dental Company (NDC), was contracted to administer the dental plan for BCC affiliates in Hawaii. A summary of the dental plan benefits is as follows:

Annual Maximum	$1,000 per person
Oral Surgery	80% Covered
Orthodontics	50% Covered (lifetime maximum of $1,600)
Preventive Care	$15 per year deductible; 100% covered thereafter
Restorative Care	80% Covered
Sealants	100% Covered (two sealants per tooth per lifetime)

NDC has a Preferred Dentist Program (PDP). Dentists can sign up to participate in the PDP if they meet specifice criteria and agree to accept NDC's payment schedule as full payment for services provided to NDC participants. Although NDC dental patients are free to seek dental treatment from any dental provider of their choice, there are advantages to patients who choose to receive care from a preferred dentist. Because of NDC's size and negotiation power, the maximum allowable limits that dentists can charge for specific services are often lower than the average charges available from competing dentists. Therefore, the dollar amount an NDC patient will have to pay for his or her share of the cost will be smaller. In addition, since preferred dentists agree to NDC's maximum allowable charges, the patient will not be liable for additional amounts. If a patient seeks dental treatment from a non-participating dentist, NDC will still pay the contracted percentage of its maximum allowable amount, but the patient, in addition to paying his or her share of that amount, will also be responsible for any excess charges if the dentist's normal fee is above the maximum allowable amount.

Many states charge a sales tax when goods are purchased in the state. Some also charge a sales tax on services. Instead of a sales tax, Hawaii has a GET which is a tax a business must pay on its gross revenues. Because it is a tax on businesses, companies that sell either goods or services in Hawaii, including doctors and dentists, must pay this tax. Although not required to do so, Hawaii businesses are allowed to include the GET in the price charged to consumers. Many Hawaii businesses separately itemize this tax on invoices/receipts and add it to the posted selling price. Thus, it appears similar to a sales tax which is added to the posted selling price. [See Explanation Boxes 2 and 3]

Specific Situation

Daniel Jacobsen is an employee at the company described above who has five small children. His wife stays at home as a mother and homemaker. Because of the high cost of living in Hawaii and a single income for the family, Daniel and his wife are quite conscientious in controlling their expenditures. Therefore, when they found out about the change to the NDC dental plan in 1999, they were anxious to make sure the dentist they used was a participating dentist. Using the NDC list, they chose Dr. Lee. Three of Daniel's children received services from Dr. Lee.

[2]The names of this coordinating company, the dental insurance company, and the individuals mentioned later have been changed. The basic facts given represent a real-life situation.

Although some doctors/dentists bill their normal charges even though they know they will only receive payment bases on the maximum allowable charges, Dr. Lee only billed the maximum allowable charges of $589.00. NDC paid $489.40. Of course, the remainder for the deductibles and the co-insurance was Daniel's responsibility. Therefore, Daniel expected to pay a total of $99.60 for these dental services.

When Daniel received the bill from Dr. Lee's office amounting to $23.56 more than he expected to pay, he inspected the bill more closely and discovered that he had been billed for tax at the rate of 4% of the total fees charged (4% x $589.00 = $23.56). Daniel was an accounting professional and knew more about taxes than many people. He called Dr. Lee's billing office and pointed out that the tax billed was not a sales tax, that the rate usually charged as an add-on tax is more than 4%, and that the tax was the GET which was a tax on business revenues, not a tax on the consumer. Both Daniel and Dr. Lee's biller called NDC to clarify its policies. Points made by these two individuals are shown in Table 1.

Daniel was also concerned about his flexible spending account (FSA) reimbursements. He had established a flexible spending account and would be reimbursed from this account for all of his eligible out-of-pocket medical and dental costs, including any amounts for taxes on the services. BCC administers his FSA and requires an Explanation of Benefits statement for reimbursement of dental costs. Therefore, Daniel knew that if he paid any taxes directly to the dentist that were not reflected in the charges billed to NDC, those taxes would not be listed on the related Explanation of Benefits statements and would therefore not be eligible for reimbursement from his FSA. [See Explanation Box 4]

The biller from Dr. Lee's office performs many of the routine bookkeeping functions for the office. However, she relies on your accounting/consulting firm to perform other accounting functions, prepare annual financial statements, prepare tax returns, and provide appropriate consulting services. Therefore, she calls you to get your advice on this particular situation concerning Daniel Jacobsen. You can help both parties by responding to the questions relating to this specific case found in the next section.

Case Questions

The questions are divided into five sections. The first section contains questions which relate to the specific case presented here. You are to address the questions in this set as the consultant contacted by Dr. Lee's office. The reasons you give for your answers should be simple enough and complete enough to satisfy both parties involved. The other four sections relate to the topics in the four explanation boxes which accompany the case. These questions may be addressed based on your prior knowledge, what you learned from the explanation boxes, and careful thought about the issues addressed. Your teacher will indicate which questions you should consider and the appropriate format for your prepared responses, oral or written.

Questions about the Specific Case Situation

1. Is Daniel Jacobsen responsible for the Hawaii GET on the dental services provided for his children by Dr. Lee? Why or why not?

2. Dr. Lee's office has charged tax at a 4% rate. If the Hawaii GET that a business has to pay is 4% of the total revenue (including the tax), will a 4% tax add on be enough to pay the tax?

3. Why is this specific situation important to Daniel Jacobsen? Do you think he would go broke if he just paid the $23.56? What might be the impact if you extrapolate the amount to a large group of patients?

4. Why is this situation important to Dr. Lee? Do you think he would go broke if he just gave up the $23.56? What difference does it make to a dentist if he or she can or cannot collect the extra 4%? What might be the impact if you extrapolate the amount to a large group of dentists or to an entire insurance company or the insurance industry?

5. Suppose Dr. Jones, another dentist whose office is close to Dr. Lee's office, also treats a patient, Sandra Clark, who is covered by the NDC dental plan. However, suppose that Dr. Jones is not a participating provider. If Dr. Jones willingly billed NDC for the services and then bills Sandra for the amount not paid by NDC, including the tax, would Sandra be responsible for the Hawaii GET? Why or why not?

6. Evaluate and comment on each of the points made in Table 1.

7. How can Daniel and Dr. Lee resolve their disagreement? What steps should they take? How can they resolve the underlying issues that have led to the disagreement? What steps should they take?

Questions about Insurance and Contracting

1. Describe what you think the terms of the following contracts might be. How formal are each of the contracts?

A. The contract between the employee and the employer (relative to the dental insurance benefits).

B. The contract between the employer and the dental plan provider.

C. The contract between the dental plan provider and the participating dentists.

D. The contract between the dental plan provider and a dentist who accepts the plan insurance payments but who is not a participating dentist.

E. The contract between the patient (employee) and the dentist.

2. What are some of the reasons why an employer or insurance company might require an employee/patient to pay (1) part of the cost of the insurance premiums, (2) a deductible, (3) a co-payment, and/or (4) a co-insurance percentage for certain procedures?

3. What are some of the reasons a dental insurance plan might have (1) a maximum dollar limit to the annual benefits available to a particular patient, or (2) limits on the frequency of benefits for certain procedures (for example, a limit on paying for teeth cleaning twice per year)?

4. Why do you think a doctor/dentist would sign up as a participating provider with a specific insurance plan if the maximum allowable amounts the insurance company sets for various procedures are less than the amounts the doctor/dentist normally charges for those procedures?

Questions about Sales Tax

1. The sales tax is a tax on consumption. Other taxes can tax income (federal or state income tax), ownership (property taxes), wealth transfer (gift or estate taxes), or employment (social security and unemployment taxes). What advantages can you think of for taxing consumption? What disadvantages can you think of for taxing consumption?

2. What reasons can you think of why a state would not require a sales tax on food or medicines?

3. Is a sales tax a fair tax? Why or why not?

4. Does a sales tax provide a stable source of revenue for the governmental entity that levies (charges) the tax? Why or why not?

5. What degree of certainty does a taxpayer have relative to the amount of sales tax he or she will have to pay each year?

6. How easy is it for a governmental entity to assess and collect a sales tax relative to other taxes?

7. How convenient is a sales tax to the consumer/ taxpayer relative to other types of taxes?

8. Governmental entities want to make sure that taxpayers comply with their tax laws. What are the advantages and disadvantages of a sales tax in promoting taxpayer compliance with the tax?

9. A tax is more efficient as the cost of administering and collecting the tax (including the taxpayer compliance cost) is minimized relative to the amount of tax collected. How efficient do you think a sales tax is?

10. Regarding accounting journal entries, companies may initially record (1) sales taxes separate from the sales revenue (as sales tax payable), or (2) the total amount received as sales revenue. If the company initially records the sales transaction using method 2, it must later determine how much of that amount is really sales tax payable rather than sales revenue. This amount could then be transferred from the sales revenue to sales tax payable.

A. What types of companies would be most likely to use the first method? Why?

B. What types of companies would be most likely to use the second method? Why?

C. What journal entries would be appropriate under each method to record (1) the collection of the revenue with the tax, (2) the transfer

from sales revenue to sales tax payable for the second method, and (3) the payment of the sales tax?

Questions about the Hawaii General Excise Tax

1. If the Hawaii GET rate is 4% but is charged on the total business revenues received (including the GET), how would you calculate the rate that would be charged to a customer if the GET is treated as an add-on tax? What is that rate?

2. Although the Hawaii GET is a tax on business revenues, some people claim it is still a tax on the consumer. Why might people make this claim? Do you agree or disagree?

3. What do you think is meant when the Hawaii GET is referred to as a pyramiding tax?

Questions about Flexible Spending Accounts

1. If your employer gave you an option of contributing to a flexible spending account to cover your medical expenses, would you want to take the option? Why or why not? If so, what factors would you consider in determining how much to contribute?

2. What are the disadvantages of underestimating your medical expenses in contributing to a medical flexible spending account?

3. What are the disadvantages of overestimating your medical expenses in contributing to a medical flexible spending account?

Teachers' Notes

Because this case is a real-life situation, students will likely find it interesting. Although it involves a specifice situation with an individual, the related issues involve companies and the way they contract with each other, the way they resolve conflicts, and whether or not they understand specific tax laws.

The various sections of questions can be assigned to the students according to your objectives in discussing the case. The questions which relate to the explanation boxes can actually be used separate from the case if you want to have your students read and discuss the explanations without reading the specific case situation. Although some technical material is involved, much of it is presented separately in the explanation boxes to make it easier for students to understand.

Guidance on Questions:

Questions about the Specific Case Situation

1. No. Although Hawaii does allow businesses to add this tax and charge it to consumers, the contract that NDC has with Dr. Lee as a participating dentist limits the amount that can be charged for each procedure to the maximum allowable amount. Since the Hawaii GET is a tax on the business, the business must cover its costs, including its cost for the excise tax, from its revenues. Therefore, the limit is not one imposed by the state but one imposed by the contract between the dentist and the insurance company.

2. A 4% tax add on will not give the dentist enough extra to pay the full tax. In this case, if Dr. Lee collected an additional $23.56 from Daniel for the tax, Dr. Lee's total revenue from these services would be $612.56 ($589.00 + $23.56). The tax would then be 4% x $612.56 = $24.50, more than the amount of the tax collected from Daniel.

3. A variety of answers are acceptable. Daniel might not go broke by paying the $23.56, but the amounts would add up over time if he continued to pay the tax. He may also be concerned about his colleagues who may be paying this tax. He is also probably concerned that the dentist is billing more than what NDC promised he would have to pay. The amount becomes very significant if extrapolated to a larger group of patients.

4. A variety of answers are acceptable. The small amount in the case is probably not important to the dentist. However, he does need to cover all of his costs from his revenues. Costs might include rental of the office and equipment; electricity and other utilities; supplies for x-rays, fillings, etc.; wages and salaries for the receptionist, biller, nurses, dental hygienist, and himself; custodial costs; and advertising costs. If a dentist were able to bill $500,000 of services per year but was unable to add on the GET, he or she would have to pay $20,000 out of the $500,000 for the tax. That $20,000 could make a big difference in whether or not he or she could make enough money to stay in business. The amount becomes very significant if extrapolated to a larger group of dentists or to an entire industry.

5. Although Sandra can get NDC to pay part of her dental bill, she has no guarantee on the maximum allowable amount that can be charged. She is responsible for whatever costs are not covered by the insurance company. In this case, the dentist could add the GET to her bill, and she would be responsible for payment. The state of Hawaii allows the dentist

to add the tax to the bill and there is no other contract with NDC to limit the amount. Therefore, Sandra is not protected by a contract between the dentist and the insurance company because Dr. Jones is not a participating dentist with NDC.

6. Dr. Lee's Office

–Although it is an excise tax, not a sales tax, Dr. Lee's office may have always charged this to the consumer. The state of Hawaii does allow businesses to add the GET to the sales price. However, when the dentist contracts with NDC or other dental insurance programs and agrees to honor the maximum allowable charges, the tax would need to be included in the maximum, not added separately.

–The insurance company would pay the tax if it were already included in the fee charged by the dentist and if the fee, including that tax, was not in excess of the maximum allowable charge.

–A business' revenues need to cover its costs. In the long run, the consumer does pay the tax. However, the tax could be charged to the patient as part of the regular fee or as an add-on tax.

–The dentist's contract with NDC does not mention taxes because the tax is irrelevant to the contract. The dentist can charge up to the maximum allowable amount for a specific procedure. NDC does not care how the amount charged within that limit is calculated or whether or not it includes the tax.

-If a patient covered by NDC uses a participating dentist, the dentist has already contracted not to charge an amount in excess of the maximum allowable amount. Therefore, the fees not covered by NDC can be charged to the patient but only so long as the total does not exceed the maximum allowable amount.

Daniel Jacobsen

–It is true that Hawaii has no sales tax. The GET sometimes looks like a sales tax because most businesses add it on to the posted sales price like a sales tax.

–A dentist is responsible, like other businesses, for paying the GET. However, to be profitable and continue operating, dentists must cover their costs, including the cost of the GET, through the revenues charged to patients, whether paid by insurance companies or the patients.

–Even though the GET is a tax on the business and not on the consumer, it will ultimately be paid by the consumer, either as part of the sales price or as an add-on tax.

–BCC has contracted with NDC to provide dental services from its participating dentist at specific rates. Since an NDC participating dentist has also contracted with NDC to accept these amounts, he or she cannot charge a patient extra amounts, for taxes or for any other reason.

7. Many responses are possible here. You can choose to focus the discussion on communication and negotiation or you can focus on other aspects of conflict resolution. You can also focus on either the specific charge of $23.56 or the principle involved. You may focus on short-term or long-term solutions. Daniel could contact BCC and the NDC so they can resolve the issues. Dr. Lee could consult with other dentists, companies, and others as appropriate to resolve the issues.

Questions about Insurance and Contracting

1. A. The employment contract with the salary/wage level may be fairly formal. Implicit in this contract is the benefit package. The specific details of the benefit package are probably outlined in an employee handbook. The details of the insurance benefits may change slightly over time without changes in the employment contracts. In a unionized environment, the contracts, including benefits, may be even more formalized. Relative to dental insurance, since most employers would not provide self insurance, the contract is probably just an agreement to provide dental insurance to the employees through a separate company.

B. This contract would be quite formal. The employer would offer the desired benefits at the lowest cost. The contract would (1) stipulate how much the employer would pay, (2) define the employee group, and (3) define the benefits that would be provided in terms of covered procedures, deductibles, co-payments, co-insurance, etc.

C. The terms of the contract are probably set up by the insurance company. Individual dentists can then decide whether or not they would like to sign up to be participating providers under the terms specified. Although the parties would probably sign a contractual agreement, the agreement would not be negotiated with each dentist, but would be a form contract based on the terms previously set up by the insurance company.

D. There would be little, if any, formal contract in this case. Although the dentist may be expected to follow specific billing procedures in order to receive payment, the agreement in this case

is really between the dentist and the patient. The patient's insurance company has agreed with the patient to pay part to the cost, and the dentist has informally agreed to accept payment from the insurance company in behalf of the patient.

E. The patient contracts with the dentist to pay for services received. Usually this is accomplished when the patient signs a form when first visiting a dentist. If the dentist is a participating provider for a specific dental insurance company that the patient is affiliated with, the dentist has an implicit agreement with the patient (based on the explicit agreement with the insurance company) not to charge more than the maximum allowable charges.

2. When patients pay part of the cost for their insurance or for part of the cost of the actual benefits received, they are more likely to realize that there is a cost involved in receiving the insurance benefit. These costs might help patients be more conscious about how they use these benefits. These direct costs to patients might also cause them to be more consumer oriented and question charges that seem too high or which are not fully understood. Such charges to patients might help them be more responsible in their use of benefits. Requiring patients to pay for part of the cost of the benefits can also reduce the costs the insurance company will have to pay, allowing the insurance premiums to be lower than they would be with 100% coverage. These costs might encourage patients to seek only necessary medical treatment.

3. These policies help limit the amount of risk the insurance company is bearing. These limits can make it easier for the insurance company to determine how much exposure it has for possible insurance claims during the year. These policies also help patients to realize that the benefits are not free and encourage them to seek only necessary dental service.

4. The dentist may be able to increase the number of patients he or she has by becoming affiliated with an insurance plan which will publish his or her name on its list of participating dentists. Even if the plan's maximum allowable amounts are less than normal fees, the dentist might save some advertising or other costs in obtaining these additional patients and revenues. A dentist may have an easier time collecting money from reputable insurance companies than from individuals, so the average amount of money collected per patient will be higher even if the maximum allowable charge is lower.

Questions About Sales Tax

1. In general, taxing consumption can be seen as a method of encouraging savings and investment which can stimulate the economy. However, taxes on consumption are usually regressive. A regressive tax is one that implies that those who have less income or wealth are required to pay a higher percentage of their income or wealth on the consumption-oriented tax. This occurs when poorer people still have to consume the necessities even though they may not have much, if any, discretionary spending power. Therefore, these people pay a higher percentage of their income or wealth on taxes since all/almost all of their income or wealth will be used for consumption.

2. Poor people spend a higher proportion of their income on food and medicine, necessities of life. If a state charges sales tax on these items, poor people will pay a disproportionately large share of the sales taxes. Some states exempt food and/or medicines from the sales tax so poor people (presumably those who can't afford it) won't have to pay the taxes.

3. Students may have several different answers here. Students who understand the sales tax as a regressive tax may say it is not fair to poor people. On the other hand, some students may think the tax is fair because everyone pays the same tax rate when items are purchased.

4. A sales tax usually provides some stability in government revenues. However, in the event of a recession, less consumption may take place, jeopardizing the level of sales tax revenues. This would be especially true if essential things such as food are not taxed, because it is the purchase of luxuries that will vary the most in the case of an economic downturn.

5. This will depend on the consumers' buying habits. Of course, if an unusual, major purchase will take place, the sales tax will be higher. Although the dollar amount of the tax may not be certain, the percentage is quite certain. Therefore, the consumer can know how much tax will be required for each transaction before it occurs.

6. Because the government essentially requires businesses to assess, collect, and remit the tax, it is relatively easy to administer. Of course, the government still has to follow up with the sales tax returns filed by the various companies and must develop ways to handle companies that are late or do not file.

7. Although consumers don't like to pay taxes, the sales tax is relatively convenient because it is paid at the time of an existing transaction and does not require any special tax forms.
8. A sales tax is collected at the point of sale by the seller. Unless the buyer and seller agree to cheat the government, there is really no way for the buyer to avoid tax compliance.
9. Individuals who pay sales tax do not have to file tax forms. Businesses that collect the tax have to file tax forms to remit the sales tax, but the number of businesses is much lower than the number of individuals. Since fewer entities must file tax forms, the taxing entity will be able to process fewer forms. In addition, a sales tax is usually very easy to calculate and does not require the same complication as many other taxes such as the income tax. From these viewpoints, the sales tax is quite efficient.

10. A. Companies that use cash registers or computer-interfaced point-of-sale equipment will likely use the first method and record the sales revenue and the sales tax in separate accounts. This method saves the trouble of determining later how much to move from sales revenue to sales taxes payable.

B. Street vendors or others without cash registers may simply determine the total amount received and record that as sales revenue, calculating later the amount of the total that should be moved from sales revenue to sales tax payable. An example where this method might be employed is a street vendor selling hot dogs for $1.50 each. Rather than adding a few cents of tax to the sales price and worrying about making change in small-value coins, the vendor will work mostly with bills and larger coins. In effect the vendor is implying that the sales price of the hot dog is less than $1.50 but that the price plus sales tax is $1.50. The vendor would then be responsible for determining the amount of the total that represents sales tax. (If the sales tax rate is 4%, the sales revenue would be $1.44 and the other $0.06 would be the sales tax payable [$1.50/1.04=$1.44]).

C. Method 1

1. Cash xx
   Sales Revenue xx
   Sales Tax Payable xx
2. __
3. Sales Tax Payable xx
   Cash xx

Method 2

1. Cash xx
   Sales Revenue xx
2. Sales Revenue xx
   Sales Tax Payable xx
3. Sales Tax Payable xx
   Cash xx

Questions about the Hawaii General Excise Tax

1. Since the GET is 4% of the total revenue including the tax, you must use algebra to calculate the tax rate that would need to be charged if you are treating the GET as an add-on tax. The calculation of the rate is as follows:

4% tax
Selling Price=SP
Total Amount to be Collected=TAC

$$SP + 4\%(TAC) = TAC$$
$$SP = TAC - 4\%(TAC)$$
$$SP = 0.96(TAC)$$
$$(1/0.96)SP = TAC$$
$$1.04166(SP) = TAC$$

Based on this calculation, the total amount to be collected must be 1.04166 times the selling price, thus, the tax rate is 4.166%. Adding on 4.166% will allow the seller to pay 4% of the total amount collected for the GET and still have the posted selling price left over.
2. Whether the tax is collected as part of the posted selling price or is treated as an add-on tax, the customer is paying the tax. To be profitable, a business must cover all of it costs, including its taxes, by generating sufficient revenues. Since the revenues are generated by charging customers, the customers end up paying the tax.
3. The GET is referred to as a pyramiding tax because it is assessed and added onto the price of a product at each level of the supply chain. Even though the rate at the wholesale and manufacturing levels is only 0.5%, the tax, whether it is 0.5% or 4%, must be paid at each level. Therefore, the tax pyramids by being added at each level. A Sales tax is only added at one level when the final consumer buys the product (or service).

Questions about a Flexible Spending Account

1. You will save money using a flexible spending account because your out-of-pocket medical expenses

can be paid with earnings that will not be subject to income taxes. However, there are some factors to consider. If you expect extremely small out-of-pocket medical expenses, the time and trouble to sign up for the FSA may not be worth your effort. If you have to pay a fee to participate, you would want to compare the fee with the amount of taxes you will save. It is also difficult to estimate how much money you may spend on the coming year in out-of-pocket medical expenses.

2. If you underestimate your medical expenses, you will end up with some out-of-pocket medical expenses that will not be reimbursable from your FSA. Although you are paying the money either way, the money reimbursed from an FSA is not subject to state or federal income tax, so your net cost is less. For any excess medical expenses that are not reimbursable from your FSA, you will not have saved the taxes but will, in effect, pay the entire amount.

3. The disadvantage of overestimating your medical expenses when you establish an FSA is that you will forfeit any money that you contribute to the account which is not used for legitimate medical expenses during the year.

What Happened?

Daniel received a letter from Dr. Lee's office which canceled the patient/dentist relationship. Daniel contacted the billerat Dr. Lee's office. She indicated that Dr. Lee could not operate his dental clinic at the amounts on NDC's payment schedule if he was unable to collect the GET in addition. She also indicated that since Daniel's first inquiry, other patients had also inquired about the tax they were charging. The biller indicated that Dr. Lee was considering discontinuing his affiliation with the NDC preferred dentist program.

Dr. Lee works mostly with Hawaii dental insurance companies that understand the Hawaii GET. These companies specifically exclude the GET as a covered item. Therefore, patients are billed for the Hawaii GET above and beyond their deductibles and co-payments. Dr. Lee probably did not fully understand the ramifications of contracting with a mainland insurance company such as NDC.

NDC may not have been fully aware of how the Hawaii GET works. NDC may not have understood that dentists were charging the GET to the patients as an additional amount beyond any deductibles and co-payments.

The author sent the case to an individual at BCC who apparently forwarded a copy to NDC. Within a few months, the NDC policy in Hawaii was changed. Under the new policy, Hawaii dentists were allowed to bill the Hawaii GET as a distinct item, separate from the dental procedures performed. NDC would then pay the entire GET without even counting it against the $1,000 per person annual maximum. The result of the new policy is that NDC patients in Hawaii can now pay exactly what they expect to pay when using NDC's PDP dentists and that these dentists can still get paid for the GET they charge.

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Explanation Box 1

Insurance Benefits/Plans/Terminology

Many employers offer benefits to their employees in addition to a wage or salary. Some of the common benefits offered are health insurance, dental insurance, and life insurance. The employer may pay for the full cost of these benefits or it may require the employee to participate and pay a certain dollar amount (perhaps a certain percentage of the cost of the benefit) toward the cost of these benefits.

Health insurance and dental insurance plans can come with various features. Sometimes a deductible (an amount that the employee/patient must pay for the plan year before the insurance will pay anything) is required.* Often, a co-payment is required for various services such as a visit to the doctor's office. In the case of a co-payment, the patient would be required to pay a certain amount toward the cost of that service, and the insurance company would pay the remainder. In addition, an insurance company may require the patient to share in the cost of some procedures by paying a certain percentage of the cost (20% for example). This sharing of the costs is called co-insurance.

With rising health and dental care costs, insurance plans will often contract with health and dental care providers for specific maximum charges for various types of procedures. For example, the maximum allowable charge for a particular well baby visit to the doctor may be set at $50. If the doctor has accepted the contract with this insurance plan and if he or she normally charges more that $50 dollars for this visit, he or she will waive any fee in excess of the $50 amount when a patient using that particular insurance plan comes for that service. Thus, the patient is only responsible for the co-payment, if any, or any required co-insurance payment (assuming the deductible, if any, has already been satisfied).

Some insurance plans may have an annual dollar limit on how much the insurance will pay. This may be true especially for dental plans. Sometimes medical or dental plans also limit the frequency of coverage for particular procedures. For example, coverage for dental cleanings may be limited to once or twice per year.

Oftentimes, after charging the appropriate co-payment at the time of the patient's visit, medical and dental providers are willing to process claims directly with insurance providers for services provided to their patients. Then the service provider will bill the patient for the difference that is not paid by the insurance company. Sometimes the patient is responsible for paying the entire bill at the time of service and can be reimbursed later, either directly from the insurance company or through the medical/dental provider as it receivers the insurance payment, for the amount covered by the insurance. In these cases, the service provider may file the insurance claim or the patient may be required to file the claim personally.

When a claim is processed by the insurance company, the appropriate amount and supporting documentation is sent by the insurance company to the service provider. In addition, the insurance company will send an Explanation of Benefits statement to the insured party showing the amount billed by the provider, the maximum amount allowed by the insurance company, the amount paid by the insurance company, and the remaining amount that the patient owes.

*For home and car insurance, a deductible is similar except that is must be satisfied by the insured party for each different claim, not just for a year. For example, if someone has two car accidents in the same year, he or she would be responsible for the deductible amount for each accident before the insurance company will make any payments.

Explanation Box 2
Sales Tax

Sales taxes can be assessed by state or local governments in the United States. A sales tax is an additional tax the consumer must pay to purchase goods (and perhaps services). It is usually calculated as a specific percentage of the purchase price. For example, if a consumer buys an item with a price of $100 and the state sales tax rate is 4%, the seller is obligated to collect the additional $4 (which equals 4% of the purchase price) in addition to the $100 collected for the selling price. The extra $4 collected is a liability of the selling company. This liability is satisfied when the selling company remits the money to the state (this would be done periodically according to state requirements).* Even though the seller is obligated to collect and remit the sales tax to the state, it is a tax on the consumer. This tax is added to the posted selling price of the product.

A sales tax can be considered an add-on tax since it is added on to the posted selling price of the product. Customers know that the amount they will have to pay will be higher than the price posted for the product.

Some states exempt certain items from sales tax. For example, some states only charge sales tax on products, not on services. Other states may not charge sales tax on medications or on food products.

Sales taxes are usually charged only to the final consumer. Therefore, suppliers do not need to collect sales taxes from the wholesalers they sell to. Only the final seller collects and remits the sales tax. In addition, because sales taxes are assessed to consumers, states can exempt certain consumers such as nonprofit organizations from paying sales tax.

Since a sales tax is a tax on the consumer and not on the business, sales taxes are not an expense of the business when it calculates its income. However, the sales taxes collected are also not a revenue of the business. The business is simply acting as an agent for the government in collecting and remitting the tax it imposes on the consumers.

*Some tax jurisdictions will allow the company collecting the sales tax to keep a small percentage of the tax as "payment" for the work done in collecting, tracking, and remitting the tax.

Explanation Box 3
Hawaii General Excise Tax

The GET in Hawaii is not the same as a sales tax. The GET is a tax businesses must pay on their gross revenues. The rate is 4%. Although the GET is a tax on the business rather than a tax on the consumer, businesses must generate enough revenue to cover all costs including taxes. Therefore, taxes on businesses (including income tax, property tax, the GET, and others) are charged to the consumers either as a part of the posted selling price of the product or service or as add-on taxes. Businesses in Hawaii are allowed to add the GET to the posted selling price of the product (add-on tax). Thus, most people perceive the GET to be the same as a sales tax. However, since the GET is a tax on gross business revenues, not on the posted selling price to a consumer, businesses in Hawaii must actually collect more than 4% of the selling price if they are going to treat the GET as an add-on tax. If a consumer purchases an item in Hawaii with a selling price of $100, $104 is not enough to cover the selling price plus the GET because the tax would be 4% of the gross revenues of $104, [4% x $104 = $4.16], more than the extra $4 collected.

Each company in the supply chain for a certain product or service must pay the GET, although wholesalers, manufacturers, and intermediaries only have to pay 0.5%, not 4%. These taxes get added on at each level of the supply chain. Thus the final consumer may actually end up paying several levels of tax.

Since the GET is a tax on the business, not the consumer,

–businesses are not obligated to collect this tax as an add-on tax. However, if they don't, they will need to pay the tax from what they collect as the selling price.

–non-profit groups are not exempt from paying taxes on purchases because the business they are buying from is liable for the tax. Hawaii does not have a good way to exempt certain consumer groups from paying the GET since it is not a consumer tax. On the other hand, Hawaii can exempt certain organizations from paying the GET on at least some revenues. For example, nonprofit entities may be exempt from paying the GET on revenues from dues, donations, and gifts (but not on other revenues such as those from fund-raising events).

–the GET is an expense of the business when it calculates its income. The GET is also included in the business' revenues even if it is treated as an add-on tax. The business is required to pay 4% of its revenues to the state for the GET. This is one of the costs of doing business in Hawaii.

Explanation Box 4
Flexible Spending Accounts

Some employers offer employees a plan whereby they can pay out-of-pocket medical expenses such as co-payments, deductibles, and co-insurance amounts through a medical flexible spending account. Costs for items such as eyeglasses and hearing aids can also be paid through a flexible spending account. The basic guidelines for a flexible spending account (FSA)* are as follows:

1. The employee authorizes the employer to withhold a specific amount from his or her paychecks during the coming year for a medical FSA. This amount is set for the year and can only be changed under special circumstances.
2. With appropriate documentation, the employee requests reimbursement from his or her FSA for out-of-pocket medical expenses that are not covered by insurance. For deductibles, co-payments, or co-insurance amounts related to medical or dental procedures, the documentation required may be the Explanation of Benefits statement related to the service. This statement would show what amounts were charged, how much was paid by the insurance company, and what remaining amounts were the responsibility of the patient.
3. ADVANTAGE: The amount withheld from the employee's pay is not subject to federal or state income tax withholding or the ensuing income tax. Thus, these medical expenses are paid with pre-tax dollars (the employee will not have to pay taxes on this amount of his or her pay but can still use it to pay for medical expenses).
4. DRAWBACK: A possible drawback is that if an employee contributes more to an FSA during the year than he or she spends on out-of pocket medical expenses, he or she does not get the remainder back. It is forfeited and reverts back to the employer.

Although there is no requirement to do so, an employer may charge employees for participating in a flexible spending account plan because there are certainly costs to the employer for the record keeping and processing of the plan amounts, both the contributions and reimbursements. It is also possible for an employer to contract with another company to administer its flexible spending program and process the reimbursement requests.

*Flexible spending accounts may also be available for other costs such as child care expenses or adoption expenses, but they are not specifically relevant to this case.

Table 1
Two Perspectives on the Issue

Points made by biller in Dr. Lee's office	Points made by Daniel Jacobsen
We've always charged the sales tax to the patient.	Hawaii has no sales tax. Instead, it has a general excise tax.
The insurance company won't pay for the tax.	A dentist is responsible for paying the Hawaii GET on all of his or her revenues.
Since we have to pay the tax to the state, we must charge it to the patient.	The Hawaii GET is a tax on the business, not on the consumer.
NDC's contract with participating dentists does not specifically refer to taxes nor does it say that dentists in Hawaii cannot charge tax.	My employer's contract with NDC says I will not have to pay anything more than the appropriate deductible and co-insurance if I go to an NDC participating dentist. Therefore, I should not have to pay an additional tax.
When patients go to the dentist for services, they are agreeing to pay the bill. Although dentists will accept payments from insurance companies, the patients are responsible for paying any fees not covered by the insurance company.	