Richard Paul McClellan III
LAWYER
www.taxsolutionslawyer.com

March 25, 2025

SENATE COMMITTEE on WAYS AND MEANS

Senator Donovan M. Dela Cruz, Chair
Senator Sharon Y. Moriwaki, Vice Chair

Re: **HB1173 Tax Liens; Discharge When Unenforceable**

Hearing Date: 3/28/2025, 10:00 A.M.

Dear Chair Dela Cruz, Vice-Chair Moriwaki, and Committee Members Aquino, DeCoite, Elefante, Hashimoto, Inouye, Kanuha, Kidani, Kim, Lee, Wakai and Favella:

As a licensed attorney practicing for thirty years in tax controversies, **I strongly support House Bill 1173 HD 1 for multiple reasons**.

HB1173 will help taxpayers, practitioners, and the tax authorities (DoTax and Internal Revenue Service) understand their obligations and rights. This bill requires the Department of Taxation to include the assessment date on certificates of tax lien. The assessment date helps taxpayers by informing the taxpayer of how long they have to pay off the balance. The assessment date allows the Department of Taxation and the Internal Revenue Service to readily determine priorities in cases of the sale of real property. Knowing the assessment date saves professional fees because it allows practitioners to readily advise their clients without having to request information from the Department.

A. Provision Relating to "Date of Assessment":

The "date of assessment" is extremely helpful because it:

1. enables Taxpayers to know how long they have to pay off the balance and understand the Department's position on payments in an approved payment plan;

2. allows the Department of Taxation and the Internal Revenue Service to readily determine priorities in cases of the sale of real property and the priority for distribution of proceeds. See, *Minnesota Department of Revenue v. United States*, 184 F.3d 725, 729 (8th Cir. 1999), citing *United States v. City of New Britain, et.al.*, 347 U.S. 81, at 86 (1954); and,

3. Allows practitioners to readily advise taxpayers without resorting to a specific request to the Department or time-consuming research.

B. Conforming the Discharge to Federal Practice Is Appropriate.

Conforming to the federal practice and procedures is fair to the taxpayer because the tax lien would include the expiration date on the lien document itself. Including the expiration date on the lien would make administration less burdensome upon the Department of Taxation because the lien would be essentially self-releasing.

The Internal Revenue Service typically releases expired tax liens within thirty (30) days of expiration as a matter of policy, but because the federal tax lien has an expiration date on the face of the lien, it can be considered "self-releasing." See, Internal Revenue Manual, 5.12.3.3.2 (7-15-2015).

C. The DoTax Is Appropriately Collecting Back Taxes

The Legislature is reminded that the collection statute of limitations (generally) does not apply in situations where a levy (bank levy, wage levy) has been made, or a court action to collect has been filed, prior to expiry. See, HRS § 237-40 (a) (in part, emphasis added):

> Where the assessment of the tax imposed by this chapter has been made within the period of limitation applicable thereto, the tax may be collected *by levy or by a proceeding in court under chapter 231*; provided that the levy is made or the proceeding was begun within fifteen years after the assessment of the tax. For any tax that has been assessed prior to July 1, 2009, the levy or proceeding shall be barred after June 30, 2024

According to the DoTax FYE 06/30/2024 Annual Report, page 49, the Department of Taxation issued 34,795 levies in the preceding year, slightly down from 38,712 the prior FYE. Since approximately 2015, the Attorney General, Civil Recoveries Division, has filed hundreds of court cases to reduce tax liens to judgment and collect upon the judgments.

The number of levies should be considered in light of the total civilian workforce, estimated at approximately 670,000.
https://dbedt.hawaii.gov/economic/qser/labor-force/

D. Recommendation On Effective Date

The measure should be made effective upon enactment with respect to a Taxpayer requesting the Department to issue a certificate of discharge for an existing tax lien pursuant to the amended HRS Section 231-33(g). The Department should be allocated an appropriate amount of time to update its computer program for information contained on new liens pursuant to Section 231-33(f).

The Legislature is urged to pass this thoughtful measure.

/s/ Richard McClellan

(808) 523-0449
Thomas Square Centre, 846 S. Hotel Street, Suite # 308
Honolulu, HI 96813

LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

735 Bishop Street, Suite 417 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: ADMINISTRATION, NET INCOME, GENERAL EXCISE, USE, TRANSIENT ACCOMMODATIONS, CONVEYANCE, RENTAL MOTOR VEHICLE, INSURANCE PREMIUM, MISCELLANEOUS, Discharge Tax Liens When Unenforceable

BILL NUMBER: HB 1173 HD 1

INTRODUCED BY: House Committee on Finance

EXECUTIVE SUMMARY: Requires the Department of Taxation to: (1) State the assessment date on certificates of tax lien; and (2) Issue certificates of discharge when the tax liability on which a lien is based has become unenforceable by lapse of time.

SYNOPSIS: Amends section 231-33, HRS, to require a certificate of tax lien to state the date on which the liability for the tax or taxes was assessed. Also requires the department to issue a certificate of discharge as to any liability that has been satisfied or that has become unenforceable.

EFFECTIVE DATE: July 1, 3000.

STAFF COMMENTS: Sections 6 through 14 of Act 166, SLH 2009, enacted what has been described as a 15-year statute of limitations on collection of taxes. The language added to each of the affected taxing chapters reads:

> Where the assessment of the tax imposed by this chapter has been made within the period of limitation applicable thereto, the tax may be collected by levy or by a proceeding in court under chapter 231; provided that the levy is made or the proceeding was begun within fifteen years after the assessment of the tax. For any tax that has been assessed prior to July 1, 2009, the levy or proceeding shall be barred after June 30, 2024.
>
> [Some provisions tolling the 15-year period follow.]

We understand that the Department of Taxation interprets the above language to bar any NEW collection action, and that it is therefore not required to release any preexisting liens and also may deny tax clearances to any taxpayer that has a tax debt regardless of how old that debt is.

The language in Act 166, SLH 2009, appears to have been modeled on Internal Revenue Code section 6502, which states:

> **§ 6502. Collection after assessment.** (a) Length of period.--Where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun--

(1) within 10 years after the assessment of the tax, or [list of exceptions].

The significance of the language "by levy or by a proceeding in court" in the federal statute can be explained by going back over a century. The first federal statute of limitation on collection of tax was enacted in the Revenue Act of 1918, where section 250(d) provided:

> (d) Except in the case of false or fraudulent returns with intent to evade the tax, the amount of tax due under any return shall be a determined and assessed by the Commissioner within five years after the return was due or was made, and no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made. In the case of such false or fraudulent returns, the amount of tax due may be determined at any time after the return is filed, and the tax may be collected at any time after it becomes due.

Revenue Act of 1918, sec. 250, 40 Stat. 1082 (emphasis added).

At the time, the Service believed that the prohibition was only on judicial proceedings, leaving the agency free to collect by other means, such as levy and distraint. The U.S. Supreme Court did not agree:

> There are two methods to compel payment. One is suit, a judicial proceeding; the other is distraint, an executive proceeding. The word 'proceeding' is aptly and commonly used to comprehend steps taken in pursuit of either. There is nothing in the language or context that indicates an intention to restrict its meaning, or to use 'suit' and 'proceeding' synonymously.
>
> The purpose of the enactment was to fix a time beyond which steps to enforce collection might not be initiated. The repose intended would not be attained if suits only were barred, leaving the collector free at any time to proceed by distraint. In fact distraint is much more frequently resorted to than is suit for the collection of taxes. The mischiefs to be remedied by setting a time limit against distraint are the same as those eliminated by bar against suit. Under petitioner's construction taxpayers having no property within reach of the collector would be protected against stale demands, while others would be liable to have their property distrained and sold to pay like claims. The result tends strongly to discredit petitioner's contention.
>
> ….
>
> … A reasonable view of the matter is that it was the intention of Congress by the clause here in question to protect taxpayers against any proceeding whatsoever for the collection of tax claims not made and pressed within five years.

Bowers v .New York & Albany Lighterage Co., 273 U.S. 346, 349, 351 (1927). The Court also took notice of a later version of the statute, in the Revenue Act of 1924, that applied the time limitation to "distraints" as well as "suits." *Id*. at 351. The Court affirmed judgments in the

lower courts holding that money collected by distraint beyond the limitation period had to be returned to the taxpayers from which the money was taken.

Since then, the federal courts have held that a limitation on collection by levy/distraint and lawsuits, as stated in IRC § 6502, in HRS § 235-111, and in comparable provisions of Hawaii taxing chapters, constituted a limitation on collection by any means, so that the State could not keep any money it collected beyond the statutory period.

> An element of unfairness may seem to exist on account of the inability of the collector to make a valid collection of an amount which had been timely assessed, but that would likewise be true in any case where the Commissioner has failed to make proper collection within the statutory period. Congress has provided a statutory period when collection can be made and a collector may not proceed contrary thereto. Here the remedy through which collection could have been effectively made was provided by plaintiff but released by the collector without any fault on the part of plaintiff. Collection was then made after the statute had run. Such a collection is an overpayment within the meaning of section 607 of the Revenue Act of 1928, and since a claim for refund was timely filed it is refundable to plaintiff.

Brewerton v. United States, 80 Ct. Cl. 529, 9 F. Supp. 503, 508 (1935). Subsequent federal cases also have made it clear that the Service is not allowed to keep money to satisfy a taxpayer debt if the underlying collection statute of limitations has expired.

In 2009, the Legislature also expressed support for a statute of limitations on collection. SB 118, SD 1 (2009), which contains language very similar to sections 6 through 14 of Act 166, SLH 2009, was explained in a committee report:

> The purpose of this measure is to limit the time period in which the collection of a tax by levy or court proceeding may commence to ten years after assessment of the tax.
>
> Your Committee finds that taxpayers should have the benefit of ascertaining with certainty at a future time when their tax liability comes to an end. The federal government imposes a ten-year statute of limitations on the collection of delinquent taxes. According to testimony, Hawaii is one of only four states that presently does not have some form of statute of limitations on tax collections.

Senate Stand. Comm. Rep. No. 194 (2009).

Another way to look at the situation is that if the Department receives taxpayer money through whatever means, and keeps it after the 15-year period has come and gone, the Department has collected the money "by levy," because "levy" is "the imposition or collection of an assessment, such as a tax" (https://www.merriam-webster.com/dictionary/levy). Thus, the collection would be barred by current law.

The language in the bill is based on Internal Revenue Code section 6325(a)(1), which states:

(a) RELEASE OF LIEN

Subject to such regulations as the Secretary may prescribe, the Secretary shall issue a certificate of release of any lien imposed with respect to any internal revenue tax not later than 30 days after the day on which—

(1) LIABILITY SATISFIED OR UNENFORCEABLE

The Secretary finds that the liability for the amount assessed, together with all interest in respect thereof, has been fully satisfied or has become legally unenforceable; …

The bill would align the Hawaii tax laws with the sections of the Internal Revenue Code after which the collection statute of limitations is modeled.

Digested: 3/25/25

Chamber of Commerce HAWAII

2030 BLUEPRINT
ECONOMIC ACTION PLAN FOR HAWAII

Testimony to the Senate Committee on Ways and Means
Senator Donovan M. Dela Cruz, Chair
Senator Sharon Y. Moriwaki, Vice Chair

Friday, March 28, 2025, at 10:00AM
Conference Room 211 & Videoconference

RE: HB1173 HD1 Relating to Tax Liens

Aloha e Chair Dela Cruz, Vice Chair Moriwaki, and Members of the Committee:

My name is Sherry Menor, President and CEO of the Chamber of Commerce Hawaii ("The Chamber"). The Chamber supports House Bill 1173 House Draft 1 (HB1173 HD1), which requires the Department of Taxation to: (1) State the assessment date on certificates of tax lien; and (2) Issue certificates of discharge when the tax liability on which a lien is based has been satisfied or has become unenforceable by lapse of time.

HB1173 HD1 aligns with our 2030 Blueprint for Hawaii: An Economic Action Plan, specifically under the policy pillar for Business Services. This bill promotes policies that drive economic growth, enhance workforce opportunities, and improve the quality of life for Hawaii's residents.

Hawaii requires clear and reliable procedures for extinguishing tax liens once the underlying liabilities are paid or become unenforceable after the statutory fifteen-year window. Currently, the Department of Taxation (DOTAX) may accept money for debts older than fifteen years, thereby collecting taxes beyond the statute of limitations. Somehow, DOTAX ignores the fact that if they accept money to pay down a 15+ year old debt, they are effectively collecting taxes beyond the prescribed limit. The federal law upon which Hawaii's statute is modeled has been interpreted by the U.S. Supreme Court to prohibit the IRS from retaining payments toward any debt where the federal ten-year collection window has expired. This measures, mirroring those federal standards, ensures that taxpayers are not adversely affected by old or resolved liens, thus enhancing fairness and clarity in the State's tax collection process.

By requiring the Department of Taxation to issue discharge certificates for satisfied or time-barred tax liabilities, the measure simplifies real property and financial transactions and prevents unwarranted encumbrances from remaining on public records. This approach creates a predictable business environment and strengthens confidence in Hawaii's regulatory framework. The Chamber supports this legislation because it promotes transparency, safeguards taxpayers from undue burdens, and streamlines the State's tax administration.

The Chamber of Commerce Hawaii is the state's leading business advocacy organization, dedicated to improving Hawaii's economy and securing Hawaii's future for growth and opportunity. Our mission is to foster a vibrant economic climate. As such, we support initiatives and policies that align with the 2030 Blueprint for Hawaii that create opportunities to strengthen overall competitiveness, improve the quantity and skills of available workforce, diversify the economy, and build greater local wealth.

We respectfully ask to pass House Bill 1173 House Draft 1. Thank you for the opportunity to testify.

JOSH GREEN M.D.
GOVERNOR

SYLVIA LUKE
LT. GOVERNOR

GARY S. SUGANUMA
DIRECTOR

KRISTEN M.R. SAKAMOTO
DEPUTY DIRECTOR

STATE OF HAWAIʻI
DEPARTMENT OF TAXATION
Ka ʻOihana ʻAuhau
P.O. BOX 259
HONOLULU, HAWAIʻI 96809
PHONE NO: (808) 587-1540
FAX NO: (808) 587-1560

TESTIMONY OF GARY S. SUGANUMA, DIRECTOR OF TAXATION

TESTIMONY ON THE FOLLOWING MEASURE:
H.B. No. 1173, H.D.1, Relating to Tax Liens.

BEFORE THE:
Senate Committee on Ways and Means

DATE: Friday, March 28, 2025
TIME: 10:00 a.m.
LOCATION: State Capitol, Room 211

Chair Dela Cruz, Vice-Chair Moriwaki, and Members of the Committee:

The Department of Taxation (DOTAX) offers the following comments on H.B. 1173, H.D.1, for your consideration.

H.B. 1173, H.D.1, amends section 231-33(f), Hawaii Revised Statutes (HRS), to require DOTAX to identify the assessment date for any taxes owed on certificates of tax liens.

H.B. 1173, H.D.1, also amends section 231-33(g), HRS, to require DOTAX to issue certificates of discharge for any liabilities that have been satisfied or "become unenforceable under sections 235-111, 237-40, 237D-9, 238-7, 243-14, 247-6.5, 251-8, and 431:7-204.6."

The bill has a defective effective date of July 1, 3000.

DOTAX requests that page 3, lines 5 to 6 of the bill be amended to delete the reference to section 431:7-204.6. DOTAX does not administer the insurance tax and would not be able to determine whether any liability of the insurance tax has become unenforceable.

DOTAX further requests that the effective date of the bill be amended to January

1, 2027, to provide sufficient time to identify and analyze the affected liens, issue certificates of discharge, and make necessary system changes to ensure ongoing compliance. DOTAX notes that significant time and effort would be required to determine which liens would be affected because of the various tolling provisions. For each tax debt over 15 years old, DOTAX would need to determine whether the 15-year period is tolled because (1) the taxpayer agreed to a suspension; (2) the taxpayer's assets were in control or custody of a court during any period of time; (3) the taxpayer applied for an offer in compromise; or (4) the taxpayer was outside the state for a continuous period of at least six months.

Thank you for the opportunity to provide comments on this measure.