

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR



KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

**HOUSE COMMITTEE ON FINANCE
TESTIMONY REGARDING HB 1710
RELATING TO TAXATION**

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

DATE: MARCH 2, 2009

TIME: 4:44PM

ROOM: 308

This measure, among other things, modifies certain evidentiary matters and burdens of proof. This measure also provides for a statutory tax amnesty program.

The Department of Taxation (Department) provides the following **comments, supporting and opposing this measure in parts:**

I. PART ONE—DECOUPLING FROM WELL-SETTLED TAX CONTROVERSY PRINCIPLES.

The Department has very strong concerns with the motivations of modifying well-settled tax controversy principles. The amendments proposed in this measure have the potential to greatly undermine the bedrock principles of administering an efficient self-reporting tax system to the benefit of aggressive tax practitioners and taxpayers.

OPPOSED TO DESIGNATION OF PAYMENTS—Under the current law, the Department designates payments of moneys owed the state to principal, interest, and penalties that are in the State's financial interest. Currently, state law dictates that tax payments are to be paid first to interest, then penalties, and finally the principal of taxes owed. The current regime is in the State's best interests because it ensures payments of interest (reflecting time value of money) as the priority, followed by penalties, and then principal. By paying principal last, the State is ensured the optimal time value of money when the principal is paid last and payments are spread over time. This measure unnecessarily shifts the benefit to taxpayers.

COMMENTS REGARDING EQUITABLE RELIEF AUTHORITY—Under current law, Section 6015 of the Internal Revenue Code allows for spouses to be relieved of liability in certain circumstances, including where equity requires. It is doubtful that this provision has any substantial effect on the administration of tax laws.

SUPPORT FOR CONFORMITY TO BURDEN SHIFTING WHERE TAXPAYERS COMPLY—The amendments relating to burden shifting on appeals needs to be further evaluated. The Department supports the provision that conforms to current federal tax administration law that, where taxpayers comply in all material respects, the burden of proof shifts to the government. Where taxpayers comply with substantiation and cooperation, this is a fair result. The Department recommends that the federal counterpart be adopted rather than what is proposed in the measure so that the federal case law and regulations on the issue are adopted. Conforming to Section 7491 of the Internal Revenue Code for purposes of Chapter 232 may be more efficient.

STRONGLY OPPOSED TO BURDEN SHIFTING WITHOUT MORE TOOLS TO PENALIZE PRACTITIONERS AND TAXPAYERS—The Department only supports the burden shifting feature if the Department likewise receives sufficient tools to control the aggressive tax practitioners and taxpayers. In order to ensure fairness in overall tax administration in light of this measure, the Department suggests that the Committee amend this measure to include the provisions of the Department's penalty conformance measure, HB 1155. HB 1155 adopts several of the penalties available on the federal level that are not available on the state level. For example, these penalties could include:

- **IRC § 6662 Accuracy Related Underpayment Penalty**
- **IRC § 6672 Failure to Collect and Pay Over Tax Penalty**
- **IRC § 6676 Erroneous Refund Penalty**
- **IRC § 6694 Understatement of Liability by Preparer Penalty**
- **IRC § 6700 Abusive Tax Shelter Promoter Penalty**

Only after the State tax law has been amended to appropriately adopt the penalties on the federal level should the Legislature consider lowering the standards for taxpayers. Currently, standards of conduct are substantially different for taxpayers and practitioners before the IRS and the Department. In addition, federal penalties on inflated or deflated valuations would also need to be adopted and the Department would need resources to hire its own appraisers. There is no reason for there to be substantially differing "playing fields," and, until such a reconciliation, the Department suggests this bill be held until such penalties are instituted to offset the taxpayer-favorable provisions from this measure.

II. PART II—TAX AMNESTY

The Department supports the concept of the statutory tax amnesty program as provided in this measure. The Department offers the following comments and will continue to work with the Legislature on this matter—

ELIMINATE REQUIREMENT TO PROMULGATE RULES PURSUANT TO CHAPTER 91—It is critical that the Department be given sufficient tools to expeditiously administer this tax amnesty program. The State general fund needs money NOW—not after the rulemaking process has completed. Rules can take years to complete, especially if a small business impact exists. The Department strongly recommends that either: (1) the tax amnesty program be exempted from Chapter 91 and Chapter 201M to get guidance out quickly to get money in faster; (2) the Department be allowed by Tax Information Release to provide guidance to taxpayers; or (3) the

Legislature currently institutes whatever regulatory provisions are necessary in the statute.

CONSIDER PENALTIES FOR FAILING TO COME FORWARD—The Department understands that penalizing people for not taking advantage of tax amnesty may be counterproductive. However, California provided larger penalties for people who could have used amnesty and failed to do so by doubling any penalties. There were also penalties for failing to accurately submit accurate disclosures.

III. REVENUE IMPACT

This measure will result in an indeterminate revenue gain.

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: ADMINISTRATION, APPEALS, Tax amnesty; equitable relief; burden of proof

BILL NUMBER: HB 1710

INTRODUCED BY: McKelvey and Say

BRIEF SUMMARY: Adds a new section to HRS chapter 231 to provide that a taxpayer may designate the tax period for any tax payment made by, or any penalty assessed on, the taxpayer; provided that the payment or penalty is paid pursuant to applicable provisions of law.

Adds a new section to HRS chapter 231 to provide that a taxpayer, including a taxpayer applying for spousal relief, shall be relieved of any tax liability under title 14, if: (1) by taking into account all the facts and circumstances of the taxpayer's situation, the department of taxation finds that it is inequitable and unjust to hold the taxpayer liable for that liability; and (2) no other relief is available to the taxpayer under title 14.

Amends HRS section 232-1 to provide that in any proceeding before the board of review or the tax appeal court, if a taxpayer introduces credible evidence with respect to any factual issue relevant to ascertaining the liability of the taxpayer for any tax, interest, or penalty imposed under title 14, the department of taxation shall have the burden of proof to prove otherwise with respect to the issue; provided that: (1) the taxpayer has complied with the requirements under title 14 to substantiate any disputed item or issue; and (2) the taxpayer has maintained all records required under title 14 and has cooperated with reasonable requests by the department of taxation for witnesses, information, documents, meetings, and interviews.

The department of taxation shall have the burden of proof in any proceeding with respect to any item of income that was reconstructed by the department solely through the use of statistical information on unrelated taxpayers. Also provides that the department of taxation shall have the burden of production in any proceeding with respect to the liability of any taxpayer for any penalty, additional tax or amount imposed under title 14.

Establishes a state tax amnesty program to allow taxpayers owing taxes, penalties, or interest on any tax administered by the director of taxation under HRS Title 14, except the real property tax or any tax subject to HRS chapter 249, to pay taxes due without the imposition of any penalty. The program shall begin by October 31, 2009 and be completed no later than December 31, 2009 and shall be applicable to tax liabilities for tax periods ending or transactions occurring on or before December 31, 2008.

Delineates eligibility requirements and general amnesty provisions. Requires the director of taxation to adopt rules pursuant to HRS chapter 91 as necessary, issue forms and instructions and take all actions necessary to implement this act. Directs the director to publicize the tax amnesty program in order to maximize the public awareness and participation in the program.

Stipulates that for the director of taxation shall maintain an accounting and reporting of funds collected under the amnesty program which shall be deposited into the general fund.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: Although the idea of tax amnesty may have merit for Hawaii, it should be noted that such a program may not be sufficient incentive for taxpayers to make good on outstanding state liabilities in view of the fact that interest due on delinquent federal taxes is much more onerous. For example, interest due on delinquent federal taxes may be imposed at up to 25% depending on the period when the taxes were due, while on the state level interest is imposed only at the rate of 2/3 of one percent per month or 8% per year. Thus, if a taxpayer did not pay either state or federal taxes, the deterrent determined by interest and penalties would be the federal liability which has considerably more severe penalties. Consideration should also be given to the fact that taxpayers who did not report taxable income or under reported such income would be subjecting such information to federal authorities since such information, no doubt, would be shared with the Internal Revenue Service as part of the information sharing program of the state. This may create some hesitancy on the part of delinquent taxpayers to participate in this tax amnesty program.

Thus, while the proposed tax amnesty program may reap benefits for the state, careful consideration should be given to all the ramifications of such a program and in particular fairness to those taxpayers who paid their taxes in a timely manner. Lawmakers should also consider the kind of message this sends to all other taxpayers who have paid their obligations on a timely and accurate basis. Will such an amnesty actually encourage taxpayers to avoid or delay paying their state taxes in hopes another amnesty period will be offered?

While the other provisions of the measure would appear to clarify that the burden of proof regarding the tax liability of a taxpayer shall be on the department of taxation, it is questionable whether such instances are currently treated inequitably favoring the department of taxation.

Digested 3/2/09