DAVID Y. IGE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR

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To: The Honorable Jill N. Tokuda, Chair
and Members of the Senate Committee on Ways and Means

Date: February 10, 2016
Time: 9:20 A.M.
Place: Conference Room 211, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 2923, Relating to Tax Administration.

The Department of Taxation (Department) strongly supports S.B. 2923, an Administration measure, and provides the following comments for your consideration.

S.B. 2923 makes several amendments to Chapters 231, 232, and 235 of the Hawaii Revised Statutes (HRS), relating to interest and appeals, as further discussed below. The bill is effective upon approval, except that section 3 relating to funds in the litigated claims fund will apply to amounts deposited after December 31, 2015.

Section 1

Section 1 of S.B. 2923 imposes interest on all unpaid penalties and fines under Title 14, HRS, at the rate of two-thirds of one percent a month. Currently, pursuant to section 231-39, HRS, interest only applies to unpaid penalties or fines that are added to and become part of the tax at the rate of two-thirds of one percent a month. This bill will create uniformity by imposing interest on all unpaid penalties and fines, not just the penalties and fines that by statute become part of the tax. This will also make treatment of interest on unpaid penalties similar to federal law. Section 6601(e)(2) of the Internal Revenue Code provides that interest is imposed on "any assessable penalty, additional amount, or addition to the tax." In addition to creating uniformity and clarity, imposing interest on unpaid penalties will promote compliance with the tax laws.

Section 2

Section 2 of S.B. 2923 adds a requirement that the chairperson of the Board of Review shall file a notice of transfer with the Tax Appeal Court when a taxpayer elects to transfer its tax appeal to the Tax Appeal Court under section 235-114, HRS. Currently, the HRS provides taxpayers with the right to transfer their appeal from the Board of Review to the Tax Appeal Court upon their election, but does not set forth the procedure for doing so. This bill will provide

clarity as to how a taxpayer may exercise the right to transfer the appeal (by providing written notice to the chairperson of the Board of Review) and the duties of the Board of Review upon receiving said notification (filing a notice of transfer with the Tax Appeal Court).

Section 3

Section 3 of S.B. 2923 amends section 232-24, HRS, regarding the rate of interest to be paid to taxpayers on funds held in the litigated claims fund. Currently, section 232-24, HRS, states that the rate of interest is "computed by reference to section 6621(a) (with respect to interest rate determination) of the Internal Revenue Code of 1986 (IRC), as of January 1, 2010." Section 6621(a) of the IRC provides:

> The overpayment rate established under this section shall be the sum of—
> (A) the Federal short-term rate determined under subsection (b) plus
> (B) 3 percentage points (2 percentage points in the case of a corporation).
> To the extent that an overpayment of tax by a corporation for any taxable period (as defined in subsection (c)(3), applied by substituting "overpayment" for "underpayment") exceeds $10,000, subparagraph (B) shall be applied by substituting "0.5 percentage point" for "2 percentage points".

Section 6621(b)(3) of the IRC provides that the federal short-term rate "shall be rounded to the nearest full percent (or, if a multiple of ½ of 1 percent, such rate shall be increased to the next highest full percent)." The federal short-term rate as of January 1, 2010, rounded to the nearest full percent pursuant to section 6621(b)(3) of the IRC, is 1 percent. Accordingly, the interest rates are as follows:

- 4 percent per annum for non-corporate taxpayers (the federal short-term rate of 1 percent plus 3 percent) or one-third percent per month;
- 3 percent per annum for corporate taxpayers where the amount owed is $10,000 or less (the federal short-term rate of 1 percent plus 2 percent) or one-fourth percent per month;
- 1.5 percent per annum for corporate taxpayers where the amount owed is in excess of $10,000 (the federal short-term rate of 1 percent plus 0.5 percent) or one-eight percent per month.

See IRS Revenue Ruling 2012-23, Table of Interest Rates, pp. 10, 13, 17 (attached).

This bill would simplify section 232-24, HRS, by plainly stating the interest rate, thereby avoiding the multi-step process of referring to section 6621(a) of the IRC for the formula, referring to the federal short-term rate, rounding up pursuant to section 6621(b), then adding the component parts based on the taxpayer's status.

Because, however, there are different rates for different taxpayers, the Department suggests amending the bill's language as follows:

"For purposes of this section, the rate of interest shall be [~~computed by reference to Section 6621(a) (with respect to interest rate determination) of the Internal Revenue Code of 1986, as of January 1, 2010.~~] one-third per cent a month or fraction of a month where the taxpayer is not a corporation, one-fourth per cent a month or fraction of a month where the taxpayer is a corporation and the amount of overpayment does not exceed $10,000, and one-eighth per cent a month or fraction of a month where a taxpayer is a corporation and the amount of overpayment is in excess of $10,000."

The interest rates would not change with this amendment and therefore would have no general fund impact.

Section 4

Section 4 of S.B. 2923 amends section 235-114, HRS, by requiring that the first appeal to the Board of Review or Tax Appeal Court may be made without payment of the tax assessed unless the assessment exceeds $50,000. By imposing a $50,000 limit, this bill will reduce frivolous appeals and prevent abuse of the tax appeal system by persons attempting to delay the payment of taxes.

The revenue impact for S.B. 2923 is indeterminate.

Thank you for the opportunity to provide comments.

TABLE OF INTEREST RATES
FROM JANUARY 1, 1999 - PRESENT

NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

		1995-1 C.B.	
	RATE	TABLE	PAGE
Jan. 1, 1999--Mar. 31, 1999	7%	19	573
Apr. 1, 1999--Jun. 30, 1999	8%	21	575
Jul. 1, 1999--Sep. 30, 1999	8%	21	575
Oct. 1, 1999--Dec. 31, 1999	8%	21	575
Jan. 1, 2000--Mar. 31, 2000	8%	69	623
Apr. 1, 2000--Jun. 30, 2000	9%	71	625
Jul. 1, 2000--Sep. 30, 2000	9%	71	625
Oct. 1, 2000--Dec. 31, 2000	9%	71	625
Jan. 1, 2001--Mar. 31, 2001	9%	23	577
Apr. 1, 2001--Jun. 30, 2001	8%	21	575
Jul. 1, 2001--Sep. 30, 2001	7%	19	573
Oct. 1, 2001--Dec. 31, 2001	7%	19	573
Jan. 1, 2002--Mar. 31, 2002	6%	17	571
Apr. 1, 2002--Jun. 30, 2002	6%	17	571
Jul. 1, 2002--Sep. 30, 2002	6%	17	571
Oct. 1, 2002--Dec. 31, 2002	6%	17	571
Jan. 1, 2003--Mar. 31, 2003	5%	15	569
Apr. 1, 2003--Jun. 30, 2003	5%	15	569
Jul. 1, 2003--Sep. 30, 2003	5%	15	569
Oct. 1, 2003--Dec. 31, 2003	4%	13	567
Jan. 1, 2004--Mar. 31, 2004	4%	61	615
Apr. 1, 2004--Jun. 30, 2004	5%	63	617
Jul. 1, 2004--Sep. 30, 2004	4%	61	615
Oct. 1, 2004--Dec. 31, 2004	5%	63	617
Jan. 1, 2005--Mar. 31, 2005	5%	15	569
Apr. 1, 2005--Jun. 30, 2005	6%	17	571
Jul. 1, 2005--Sep. 30, 2005	6%	17	571
Oct. 1, 2005--Dec. 31, 2005	7%	19	573
Jan. 1, 2006--Mar. 31, 2006	7%	19	573
Apr. 1, 2006--Jun. 30, 2006	7%	19	573
Jul. 1, 2006--Sep. 30, 2006	8%	21	575
Oct. 1, 2006--Dec. 31, 2006	8%	21	575
Jan. 1, 2007--Mar. 31, 2007	8%	21	575
Apr. 1, 2007--Jun. 30, 2007	8%	21	575
Jul. 1, 2007--Sep. 30, 2007	8%	21	575
Oct. 1, 2007--Dec. 31, 2007	8%	21	575
Jan. 1, 2008--Mar. 31, 2008	7%	67	621
Apr. 1, 2008--Jun. 30, 2008	6%	65	619
Jul. 1, 2008--Sep. 30, 2008	5%	63	617
Oct. 1, 2008--Dec. 31, 2008	6%	65	619
Jan. 1, 2009--Mar. 31, 2009	5%	15	569
Apr. 1, 2009--Jun. 30, 2009	4%	13	567
Jul. 1, 2009--Sep. 30, 2009	4%	13	567
Oct. 1, 2009--Dec. 31, 2009	4%	13	567
* Jan. 1, 2010--Mar. 31, 2010	4%	13	567
Apr. 1, 2010--Jun. 30, 2010	4%	13	567

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 - PRESENT

CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	1995-1 C.B. TABLE	PG	RATE	1995-1 C.B. TABLE	PG
Jan. 1, 1999--Mar. 31, 1999	6%	17	571	7%	19	573
Apr. 1, 1999--Jun. 30, 1999	7%	19	573	8%	21	575
Jul. 1, 1999--Sep. 30, 1999	7%	19	573	8%	21	575
Oct. 1, 1999--Dec. 31, 1999	7%	19	573	8%	21	575
Jan. 1, 2000--Mar. 31, 2000	7%	67	621	8%	69	623
Apr. 1, 2000--Jun. 30, 2000	8%	69	623	9%	71	625
Jul. 1, 2000--Sep. 30, 2000	8%	69	623	9%	71	625
Oct. 1, 2000--Dec. 31, 2000	8%	69	623	9%	71	625
Jan. 1, 2001--Mar. 31, 2001	8%	21	575	9%	23	577
Apr. 1, 2001--Jun. 30, 2001	7%	19	573	8%	21	575
Jul. 1, 2001--Sep. 30, 2001	6%	17	571	7%	19	573
Oct. 1, 2001--Dec. 31, 2001	6%	17	571	7%	19	573
Jan. 1, 2002--Mar. 31, 2002	5%	15	569	6%	17	571
Apr. 1, 2002--Jun. 30, 2002	5%	15	569	6%	17	571
Jul. 1, 2002--Sep. 30, 2002	5%	15	569	6%	17	571
Oct. 1, 2002--Dec. 31, 2002	5%	15	569	6%	17	571
Jan. 1, 2003--Mar. 31, 2003	4%	13	567	5%	15	569
Apr. 1, 2003--Jun. 30, 2003	4%	13	567	5%	15	569
Jul. 1, 2003--Sep. 30, 2003	4%	13	567	5%	15	569
Oct. 1, 2003--Dec. 31, 2003	3%	11	565	4%	13	567
Jan. 1, 2004--Mar. 31, 2004	3%	59	613	4%	61	615
Apr. 1, 2004--Jun. 30, 2004	4%	61	615	5%	63	617
Jul. 1, 2004--Sep. 30, 2004	3%	59	613	4%	61	615
Oct. 1, 2004--Dec. 31, 2004	4%	61	615	5%	63	617
Jan. 1, 2005--Mar. 31, 2005	4%	13	567	5%	15	569
Apr. 1, 2005--Jun. 30, 2005	5%	15	569	6%	17	571
Jul. 1, 2005--Sep. 30, 2005	5%	15	569	6%	17	571
Oct. 1, 2005--Dec. 31, 2005	6%	17	571	7%	19	573
Jan. 1, 2006--Mar. 31, 2006	6%	17	571	7%	19	573
Apr. 1, 2006--Jun. 30, 2006	6%	17	571	7%	19	573
Jul. 1, 2006--Sep. 30, 2006	7%	19	573	8%	21	575
Oct. 1, 2006--Dec. 31, 2006	7%	19	573	8%	21	575
Jan. 1, 2007--Mar. 31, 2007	7%	19	573	8%	21	575
Apr. 1, 2007--Jun. 30, 2007	7%	19	573	8%	21	575
Jul. 1, 2007--Sep. 30, 2007	7%	19	573	8%	21	575
Oct. 1, 2007--Dec. 31, 2007	7%	19	573	8%	21	575
Jan. 1, 2008--Mar. 31, 2008	6%	65	619	7%	67	621
Apr. 1, 2008--Jun. 30, 2008	5%	63	617	6%	65	619
Jul. 1, 2008--Sep. 30, 2008	4%	61	615	5%	63	617
Oct. 1, 2008--Dec. 31, 2008	5%	63	617	6%	65	619
Jan. 1, 2009--Mar. 31, 2009	4%	13	567	5%	15	569

	Apr. 1, 2009--Jun. 30, 2009	3%	11	565	4%	13	567
	Jul. 1, 2009--Sep. 30, 2009	3%	11	565	4%	13	567
	Oct. 1, 2009--Dec. 31, 2009	3%	11	565	4%	13	567
*	Jan. 1, 2010--Mar. 31, 2010	3%	11	565	4%	13	567
	Apr. 1, 2010--Jun. 30, 2010	3%	11	565	4%	13	567
	Jul. 1, 2010--Sep. 30, 2010	3%	11	565	4%	13	567
	Oct. 1, 2010--Dec. 31, 2010	3%	11	565	4%	13	567
	Jan. 1, 2011--Mar. 31, 2011	2%	9	563	3%	11	565
	Apr. 1, 2011--Jun. 30, 2011	3%	11	565	4%	13	567
	Jul. 1, 2011--Sep. 30, 2011	3%	11	565	4%	13	567
	Oct. 1, 2011--Dec. 31, 2011	2%	9	563	3%	11	565
	Jan. 1, 2012--Mar. 31, 2012	2%	57	611	3%	59	613
	Apr. 1, 2012--Jun. 30, 2012	2%	57	611	3%	59	613
	Jul. 1, 2012--Sep. 30, 2012	2%	57	611	3%	59	613
	Oct. 1, 2012--Dec. 31, 2012	2%	57	611	3%	59	613

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING $10,000

FROM JANUARY 1, 1995 - PRESENT

	1995-1 RATE	C.B. TABLE	C.B. PG
Jan. 1, 1995--Mar. 31, 1995	6.5%	18	572
Apr. 1, 1995--Jun. 30, 1995	7.5%	20	574
Jul. 1, 1995--Sep. 30, 1995	6.5%	18	572
Oct. 1, 1995--Dec. 31, 1995	6.5%	18	572
Jan. 1, 1996--Mar. 31, 1996	6.5%	66	620
Apr. 1, 1996--Jun. 30, 1996	5.5%	64	618
Jul. 1, 1996--Sep. 30, 1996	6.5%	66	620
Oct. 1, 1996--Dec. 31, 1996	6.5%	66	620
Jan. 1, 1997--Mar. 31, 1997	6.5%	18	572
Apr. 1, 1997--Jun. 30, 1997	6.5%	18	572
Jul. 1, 1997--Sep. 30, 1997	6.5%	18	572
Oct. 1, 1997--Dec. 31, 1997	6.5%	18	572
Jan. 1, 1998--Mar. 31, 1998	6.5%	18	572
Apr. 1, 1998--Jun. 30, 1998	5.5%	16	570
Jul. 1. 1998--Sep. 30, 1998	5.5%	16	570
Oct. 1, 1998--Dec. 31, 1998	5.5%	16	570
Jan. 1, 1999--Mar. 31, 1999	4.5%	14	568
Apr. 1, 1999--Jun. 30, 1999	5.5%	16	570
Jul. 1, 1999--Sep. 30, 1999	5.5%	16	570
Oct. 1, 1999--Dec. 31, 1999	5.5%	16	570
Jan. 1, 2000--Mar. 31, 2000	5.5%	64	618
Apr. 1, 2000--Jun. 30, 2000	6.5%	66	620
Jul. 1, 2000--Sep. 30, 2000	6.5%	66	620
Oct. 1, 2000--Dec. 31, 2000	6.5%	66	620
Jan. 1, 2001--Mar. 31, 2001	6.5%	18	572
Apr. 1, 2001--Jun. 30, 2001	5.5%	16	570
Jul. 1, 2001--Sep. 30, 2001	4.5%	14	568
Oct. 1, 2001--Dec. 31, 2001	4.5%	14	568
Jan. 1, 2002--Mar. 31, 2002	3.5%	12	566
Apr. 1, 2002--Jun. 30, 2002	3.5%	12	566
Jul. 1, 2002--Sep. 30, 2002	3.5%	12	566
Oct. 1, 2002--Dec. 31, 2002	3.5%	12	566
Jan. 1, 2003--Mar. 31, 2003	2.5%	10	564
Apr. 1, 2003--Jun. 30, 2003	2.5%	10	564
Jul. 1, 2003--Sep. 30, 2003	2.5%	10	564
Oct. 1, 2003--Dec. 31, 2003	1.5%	8	562
Jan. 1, 2004--Mar. 31, 2004	1.5%	56	610
Apr. 1, 2004--Jun. 30, 2004	2.5%	58	612
Jul. 1, 2004--Sep. 30, 2004	1.5%	56	610
Oct. 1, 2004--Dec. 31, 2004	2.5%	58	612
Jan. 1, 2005--Mar. 31, 2005	2.5%	10	564
Apr. 1, 2005--Jun. 30, 2005	3.5%	12	566
Jul. 1, 2005--Sep. 30, 2005	3.5%	12	566
Oct. 1, 2005--Dec. 31, 2005	4.5%	14	568
Jan. 1, 2006--Mar. 31, 2006	4.5%	14	568
Apr. 1, 2006--Jun. 30, 2006	4.5%	14	568

	Jul. 1, 2006--Sep. 30, 2006	5.5%	16	570
	Oct. 1, 2006--Dec. 31, 2006	5.5%	16	570
	Jan. 1, 2007--Mar. 31, 2007	5.5%	16	570
	Apr. 1, 2007--Jun. 30, 2007	5.5%	16	570
	Jul. 1, 2007--Sep. 30, 2007	5.5%	16	570
	Oct. 1, 2007--Dec. 31, 2007	5.5%	16	570
	Jan. 1, 2008--Mar. 31, 2008	4.5%	62	616
	Apr. 1, 2008--Jun. 30, 2008	3.5%	60	614
	Jul. 1, 2008--Sep. 30, 2008	2.5%	58	612
	Oct. 1, 2008--Dec. 31, 2008	3.5%	60	614
	Jan. 1, 2009--Mar. 31, 2009	2.5%	10	564
	Apr. 1, 2009--Jun. 30, 2009	1.5%	8	562
	Jul. 1, 2009--Sep. 30, 2009	1.5%	8	562
	Oct. 1, 2009--Dec. 31, 2009	1.5%	8	562
*	Jan. 1, 2010--Mar. 31, 2010	1.5%	8	562
	Apr. 1, 2010--Jun. 30, 2010	1.5%	8	562
	Jul. 1, 2010--Sep. 30, 2010	1.5%	8	562
	Oct. 1, 2010--Dec. 31, 2010	1.5%	8	562
	Jan. 1, 2011--Mar. 31, 2011	0.5%*		
	Apr. 1, 2011--Jun. 30, 2011	1.5%	8	562
	Jul. 1, 2011--Sep. 30, 2011	1.5%	8	562
	Oct. 1, 2011--Dec. 31, 2011	0.5%*		
	Jan. 1, 2012--Mar. 31, 2012	0.5%*		
	Apr. 1, 2012--Jun. 30, 2012	0.5%*		
	Jul. 1, 2012--Sep. 30, 2012	0.5%*		
	Oct. 1, 2012--Dec. 31, 2012	0.5%*		

TESTIMONY OF
THE DEPARTMENT OF THE ATTORNEY GENERAL
TWENTY-EIGHTH LEGISLATURE, 2016

ON THE FOLLOWING MEASURE:
S.B. No. 2923, RELATING TO TAX ADMINISTRATION

BEFORE THE:
SENATE COMMITTEE ON WAYS AND MEANS

DATE: Wednesday, February 10, 2016 **TIME:** 9:20 a.m.

LOCATION: State Capitol, Room 211

TESTIFIER(S): Douglas S. Chin, Attorney General, or a
Deputy from the Tax and Charities Division

Chair Tokuda and Members of the Committee:

The Department of the Attorney General supports this bill.

The purposes of this bill are to:

(1) Impose an interest rate of two-thirds of one percent per month on unpaid interest and penalties;

(2) Require the chairperson of the Board of Review to file a notice of transfer to Tax Appeal Court upon request of the taxpayer; and

(3) Require a taxpayer to pay the assessed amount for an appeal to either the Board of Review or the Tax Appeal Court if the assessed amount exceeds $50,000.

The Department of the Attorney General notes that this bill will protect the state treasury by requiring taxpayers who are alleged to owe large sums of monies to pay the amount in controversy while contesting the assessment in court. This will ensure that there will be funds available for the State to collect should the State prevail. If the taxpayer prevails the State will refund the amount paid plus statutory interest.

The Department of the Attorney General recommends this bill be passed.

LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, ADMINISTRATION, Omnibus

BILL NUMBER: SB 2923; HB 2394 (Identical)

INTRODUCED BY: SB by Kouchi by request; HB by Souki by request

EXECUTIVE SUMMARY: This bill addresses four unrelated administrative issues.

Interest on Unpaid Penalties and Fines: Attempts to achieve consistency between civil fines or penalties under the tax laws.

Transfer of Appeals from Board of Review to Tax Appeal Court: Adds clarity to the process by which appeals are transferred from the Board of Review to Tax Appeal Court.

Interest on Amounts Paid out of Litigated Claims Fund: Attempts to simplify calculation of interest paid by the Department on taxes paid pending appeal when the taxpayer wins; further simplification could be achieved by addressing the dichotomy between Board of Review and Tax Appeal Court appeals.

Prepayment Requirement for Appeals: Attempts to revive the "pay to play" rule that existed before the turn of the century, which adds significant burden and inequity.

BRIEF SUMMARY:

Interest on Unpaid Penalties and Fines: Adds new section in HRS chapter 231 to provide that civil fines or penalties bear interest at 8% per annum, and shall be assessed, collected, and paid in the same manner as taxes.

Transfer of Appeals from Board of Review to Tax Appeal Court: Adds new subsection HRS 232-7(f) to provide that to effectuate the transfer of a case from the Board of Review to the Tax Appeal Court, the taxpayer notifies the chairperson of the Board, who then will file a notice of transfer with the court.

Interest on Amounts Paid out of Litigated Claims Fund: Amends HRS section 232-24 to provide that such interest shall be paid at a monthly rate of __% per month or fraction thereof.

Prepayment Requirement for Appeals: Amends HRS section 235-114 to provide that when an assessment of tax exceeds $50,000, the taxpayer shall pay the assessed taxes, penalties, and interest as a prerequisite to the first appeal (from the Department of Taxation's assessment).

EFFECTIVE DATE: Upon approval.

STAFF COMMENTS: This bill is sponsored by the Department of Taxation TAX-03 (16).

Interest on Unpaid Penalties and Fines: According to the Department's justification sheet accompanying the bill, this provision is needed to bring consistency to the treatment of penalties and fines within title 14, HRS.

The bill will affect penalties and fines assessed for compliance issues rather than tax deficiencies. For example, if penalties or fines are assessed against street vendors because of the cash economy enforcement provisions, those penalties will grow over time. The policy question presented by this provision is whether the additional complexity is worth it.

Transfer of Appeals from Board of Review to Tax Appeal Court: The proposed section provides for a reasonably clear paper trail from the Board to the court, with little added complexity.

Interest on Amounts Paid out of Litigated Claims Fund: When taxes are paid pending appeal and the taxpayer is judged to be entitled to some or all of them, section 232-24 allows the taxpayer to recover interest on the amount at the overpayment rate if the appeal was made to the Tax Appeal Court; if the appeal was made to a Board of Review, *Hawaiian Land Co. v. Kamaka*, 56 Haw. 655, 547 P.2d 581 (1976), held that the State is obligated to pay the taxpayer the actual earnings of the money held pending appeal in addition to the taxpayer's overpayment.

Act 112, SLH 2010, which at the time was the Department of Taxation's annual conformity bill, changed the amount payable in a Tax Appeal Court appeal to conform to the overpayment interest provisions in the Internal Revenue Code, which was at the time around 3% while the overpayment rate in section 231-24, HRS, was 8%. Board of Review appeals were unaffected.

The proposed amendment jettisons the Internal Revenue Code provisions and replaces them with an unspecified flat percentage, while leaving the rule for Board of Review appeals intact. The Department of Taxation's justification for this proposal is that it "will add clarity and consistency to the law and greater ease of administration for the department." To further this end, this Committee should instead consider a provision that would use one interest rate for all tax overpayments and eliminate the discrepancy between Tax Appeal Court and Board of Review treatment, such as the following:

§232-24 Taxes paid pending appeal. The tax paid upon the amount of any assessment, actually in dispute and in excess of that admitted by the taxpayer, and covered by an appeal [~~to the tax appeal court~~] duly taken, shall, pending the final determination of the appeal, be paid by the director of finance into the "litigated claims fund". If the final determination is in whole or in part in favor of the appealing taxpayer, the director of finance shall repay to the taxpayer out of the fund, or if investment of the fund should result in a deficit therein, out of the general fund of the State, the amount of the tax paid upon the amount held by the court to have been excessive or nontaxable, together with from the date of each payment into the litigated claims fund, the interest to be paid from the general fund of the State. For purposes of this section, the rate of interest shall be computed by reference to section [~~6621(a)~~

~~(with respect to interest rate determination) of the Internal Revenue Code of 1986, as of January 1, 2010~~] 231-23. The balance, if any, of the payment made by the appealing taxpayer, or the whole of the payment, in case the decision is wholly in favor of the assessor, shall, upon the final determination become a realization under the tax law concerned.

[~~In a case of an appeal to a board of review, the tax paid, if any, upon the amount of the assessment actually in dispute and in excess of that admitted by the taxpayer, shall during the pendency of the appeal and until and unless an appeal is taken to the tax appeal court, be held by the director of finance in a special deposit. In the event of final determination of the appeal in the board of review, the director of finance shall repay to the appealing taxpayer out of the deposit the amount of the tax paid upon the amount held by the board to have been excessive or nontaxable, if any, the balance, if any, or the whole of the deposit, in case the decision is wholly in favor of the assessor, to become a realization under the tax law concerned.~~]

Prepayment Requirement for Appeals: The "pay to play rule" referred to in this amendment is housed in section 235-114, HRS, but it affects virtually all tax types through cross-references in sections 237-42 (general excise), 237D-11 (transient accommodations), 238-8 (use tax), 239-7 (public service company), 241-6 (financial institutions), 243-14.5 (fuel), 244D-12 (liquor), 245-10 (tobacco), 247-4.5 (conveyance), 251-10 (rental motor vehicle), 346E-8 (nursing facility), and 431:7-204.5 (insurance premium).

In the past, prepayment of assessed taxes was required for all tax appeals, with certain narrow exceptions. Act 199, SLH 2000, eliminated the prepayment of assessed taxes if the tax appeal was made to a board of review, but left intact the rule requiring prepayment if the appeal was made to Tax Appeal Court. Act 123, SLH 2004, addressed this disparity by providing that the first appeal to either forum could be made without prepayment of assessed taxes, but that any subsequent appeal would require prepayment of taxes as determined by the judgment or decision appealed from. The Conference Committee stated at the time:

> The purpose of this measure is to amend the provisions for tax appeals to provide that first appeals to either the district board of review or to the tax appeal court may be made without payment of the tax so assessed. Your Committee finds that this is a fair and equitable provision.

Conf. Comm. Rep. 131 (2004).

The Department in the current bill seeks to turn back to the clock to before the turn of the century, baldly asserting that this change is needed to discourage frivolous appeals. The prepayment requirement before appeal is a burden, especially on small businesses. Many times, the tax assessments arise from first-time audits or when the rotation of auditors produces one who does not agree with prior audit results. In these cases, the business had no reason to plan for

these contingencies and is faced with paying the disputed tax and the cost to file an action to recover the tax. If the business does not have the resources to prepay the tax, the assessment becomes final and the Department is free to collect whatever resources the business has scraped up before it goes under. In addition, the department's interpretation of the law goes unchallenged and "sets precedent" for other similarly situated taxpayers even though the position might not have stood up to impartial review. These interpretations then lead to entrenched poor interpretations of the law, legislative relief for those taxpayers who can afford lobbyists, and the tattered remains of destroyed businesses.

Digested 1/28/2016

Chamber of Commerce HAWAII
The Voice of Business

Testimony to the Senate Committee on Ways and Means
Wednesday, February 10, 2016 at 9:20 A.M.
Conference Room 211, State Capitol

RE: SENATE BILL 2923 RELATING TO TAX ADMINISTRATION

Chair Tokuda, Vice Chair Dela Cruz, and Members of the Committee:

The Chamber of Commerce Hawaii ("The Chamber") **opposes** SB 2923, which Imposes interest on unpaid penalties and fines; requires filing with tax appeal court a notice of transfer upon transfer of appeal to tax appeal court; amends rate of interest on amounts paid out of litigated claims fund; and requires full payment of assessed taxes, penalties, and interest for the first appeal where the assessment exceeds $50,000.

The Chamber is Hawaii's leading statewide business advocacy organization, representing about 1,000 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

Under current law, if a taxpayer disagrees with an assessment by the Department of Taxation, the taxpayer may take an appeal either to the Board of Review or to the Tax Appeal Court. The taxpayer may make their first appeal (to either the Board of Review or to the Tax Appeal Court) without payment. If, however, the taxpayer loses their first appeal, then any subsequent appeal can be made only after payment of the tax owed.

This bill would dramatically change current procedure and force taxpayers to make payment before having the opportunity to take an appeal. This would be the equivalent of forcing a business to make payment to plaintiffs every time they are sued, just to have the opportunity to get to court.

This is unfair and improperly places the burden on taxpayers. In some cases, the law is uncertain. Taxpayers may have arguments as to why certain revenues were exempt from tax or why taxes are not required to be paid. Further, there are situations in which the Department of Tax simply makes mistakes. Taxpayers should not be forced to pay erroneous assessments before having the opportunity to challenge those assessments.

These problems are exacerbated by the current lack of an administrative appeal process within the Department of Tax: there is currently no watchdog to ensure that taxpayers are not unjustly assessed. This bill would make that worse by eliminating the one appeal that currently exists prior to the required payment.

1132 Bishop Street, Suite 2105 • Honolulu, Hawaii 96813 • Phone: (808) 545-4300 • Facsimile: (808) 545-4369

The Department asserts that these appeals are taken for purposes of delay. This is not the case. It is true that there are many cases currently languishing at the Board of Review. To the extent that some appeals are currently languishing, it is because the Department of Tax has not caused those appeals to be heard or because there are too many vacancies on the Tax Board of Review. Taxpayers should not have to pay for the Department's delays. As the Department of Taxation gets more aggressive with its tax collection policies, this policy change could harm businesses in their efforts to exercise their appeal rights.

Thank you for the opportunity to express our views on this matter.

Ronald I. Heller
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Honolulu, Hawaii 96813

phone 808 523 6000 fax 808 523 6001
rheller@torkildson.com

Senate Committee on
WAYS & MEANS

Wednesday Feb. 10, 2016 at 9:20 a.m.
Conference Room 211

Testimony of Ronald I. Heller

In Opposition to Senate Bill 2923
Relating to Tax Administration
(Prepayment Requirement for Tax Appeals)

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

I am submitting this testimony as an individual, and also on behalf of the Tax Committee of the Hawaii Society of Certified Public Accountants.

I, and the HSCPA Tax Committee, **oppose** Senate Bill 2923, at least with respect to the requirement of pre-payment as a condition of appealing from a tax assessment. We have no opposition to the other parts of the Bill.

At one time, Hawaii law did require pre-payment before a taxpayer could challenge a tax assessment at the Board of Review or in the Tax Appeal Court. Act 199 in 2000, and Act 123 in 2004, eliminated the prepayment requirement for appeals to the Board and to the Court, respectively.

Recognizing that pre-payment imposed a substantial hardship on taxpayers, the Legislature said in the Conference Committee report on Act 204:

> The purpose of this measure is to amend the provisions for tax appeals to provide that first appeals to either the district board of review or to the tax appeal court may be made without payment

> of the tax so assessed. **Your Committee finds that this is a fair and equitable provision.** [emphasis added]

Conf. Comm. Rep. 131 (2004). This bill would reverse the provision that the Legislature found to be fair and equitable.

As justification, the Department of Taxation offers only a vague, unsupported assertion that a prepayment requirement is necessary to discourage frivolous appeals. However, the prepayment requirement was completely eliminated as of 2005 – where is the evidence of an epidemic of frivolous appeals filed in the last ten years? The Department has not shown, and cannot show, that there has been some surge in the number of frivolous appeals since 2005.

Note that they cannot claim that confidentiality prevents them from identifying particular cases. Under HRS 232-7, hearings by the Board of Review are public, and filings in the Tax Appeal Court are public records unless specifically sealed by court order. Thus, if they had examples of frivolous cases, they could tell us.

Moreover, at the federal level, taxpayers can appeal an IRS assessment to the US Tax Court without any prepayment requirement. While there are some frivolous cases filed, there has not been any significant impact on the federal budget from taxpayers filing frivolous cases to delay payment of their taxes.

The fact is that litigating a contested tax case is an expensive process. That expense alone is a significant deterrent to the filing of an appeal. Moreover, for many taxpayers, prepaying the tax **and** paying the costs of litigation would be impossible. Those taxpayers could be forced into surrendering their rights just because they lack the financial resources to pre-pay and then fight the legal battle. That would not be fair.

Finally, if a taxpayer ultimately loses a tax appeal, the ultimate amount due will be higher due to the interest that accrues while the case is pending. Under

current law, the interest rate is 8% -- a rate well above market rates. This too is a disincentive to file a frivolous appeal merely hoping to delay payment.

In short, the Department has not shown any need for a prepayment requirement, and such a requirement would be burdensome and unfair to taxpayers, especially those taxpayers with limited financial resources.

We urge you to delete the pre-payment requirement from this Bill.

Respectfully submitted,

Ronald I. Heller, individually
and on behalf of the Tax Committee
of the Hawaii Society of
Certified Public Accountants

Richard Paul McClellan III
LAWYER

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February 8, 2016

Senator Honorable Jill N. Tokuda, Chair
Members of the Senate Committee On Ways & Means

Re: S. B. 2923

Hearing Date: 2/10/2016, 9:20 a.m.

Dear Chair Tokuda & Honorable Members:

Section 1: Interest Rate: Suggest Modification

I recommend that you take this opportunity to consider the interest rate imposed on delinquent taxes in Hawaii. Interest is currently imposed at the rate of two-thirds of one percent (8% per year.) This is a staggering interest rate given our low-interest environment and is currently more than double the IRS rate (3%.) Reducing the penalty rate to one-half of one percent per month (6% per year) would be far more equitable and would presumably enable many taxpayers to clear their delinquent accounts more rapidly, thereby conserving Department resources.

Section 4: Assessment Threshold of $50,000: Suggest Rejection

There are numerous problems with "pay to play" requirements for access to judicial review.

The Department has not indicated how many "frivolous" $50,000+ appeals it has historically faced, nor how many $50,000+ assessments have been paid pending appeal.

The Department of Taxation is already insulated from many appeals by the complicated scheme of deadlines and legal requirements to perfect a tax appeal.

I recommend that you modify Section 1 as indicated above and reject Section 4.

Sincerely,

Richard McClellan

PETER L. FRITZ
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E-MAIL: PLFLEGIS@FRITZHQ.COM

THE SENATE
THE TWENTY-EIGHTH LEGISLATURE
REGULAR SESSION OF 2016

COMMITTEE ON WAYS AND MEANS
Testimony on S.B. 2923
Hearing: February 10, 2016

(RELATING TO TAX ADMINISTRATION)

Chair Tokuda, Vice Chair Dela Cruz, and members of the Committee. My name is Peter Fritz. I am an attorney and a former Rules Specialist for the Department of Taxation. I am testifying **in opposition** to this bill because requiring prepayment of a disputed assessment derives taxpayers of property before the taxpayer has the right to an independent hearing.

This bill, among other things, would require full payment of assessed taxes, penalties, and interest for the first appeal where the assessment exceeds $50,000

Pay to Play

Pay to Play is the term that is generally used when a taxpayer has to pay the assessment in order to dispute the validity of the assessment. Pay to play denies a taxpayer an opportunity for a fair hearing before being deprived of property (i.e., disputed taxes). Fairness dictates that the State must acknowledge the potential for error or bias in its determinations and provide taxpayers access to an independent appeals tribunal. It is inherently inequitable to force a taxpayer to pay a tax assessment, often based on the untested assertions of a single auditor or audit team, without the benefit of an independent hearing and the ability to establish a record before an independent trier of fact.

If a DOTAX is concerned that a particular tax assessment is in jeopardy based on the facts and circumstances before it, it should issue a jeopardy assessment on that amount. In those circumstances DOTAX needs the flexibility to move quickly and should do so as long as minimum due process protections are afforded. Such assessments are a legitimate means of protecting the State. However, the jeopardy assessments should only be used in extreme circumstances, and the burden of proving that the assessment is in jeopardy should fall on the state.

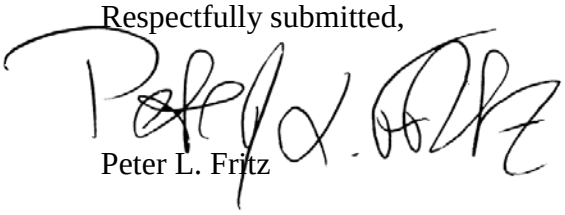
Furthermore, this bill could prompt auditors to assess additional penalties so that an assessment reaches the dollar threshold that triggers the prepayment of taxes. For example, an auditor might assert penalties such as the 25% penalty for taking a particular position just to raise the assessment to the threshold amount for an issue that could only to be decided by a court.

While the Department proffers that that that prepayment of an assessment will reduce frivolous appeals and prevent abuse of the tax appeal system by persons attempting to delay payment of taxes, it offers no substantiation in the form of the number of alleged "frivolous appeals" that result from assessments greater than $50,000.

Fairness dictates that a taxpayer should have the right to contest an assessment before an independent tribunal. Requiring prepayment of an assessment would be equivalent to to paying a traffic fine just to have the case heard in court. Taxpayers are entitled to contest and assessment before an independent tribunal without being deprived of property.

I respectfully request that the Committee hold this bill.

Respectfully submitted,



Peter L. Fritz

PAMELA W. BUNN
41-027 Hilu Street
Waimanalo, HI 96795
February 9, 2016

TO: Chair Jill N. Tokuda and Vice Chair Donovan M. Dela Cruz Senate Committee on Ways and Means

RE: TESTIMONY OPPOSING IN PART AND SUPPORTING IN PART SENATE BILL NO. 2923, RELATING TO TAX ADMINISTRATION

HEARING: February 10, 2016, 9:20 a.m., Conference Room 211

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

Having represented clients in several tax appeals, including some where the assessments far exceeded $50,000, I write to express my personal opposition to Senate Bill No. 2923 to the extent it would amend HRS § 235-114 to remove the right to appeal without first paying the assessed taxes, penalties and interest in cases where the assessment exceeds $50,000.

The ostensible justification for this change is that it "will reduce frivolous appeals." The Department of Taxation ("DoTax") has not provided any data to indicate an increase in frivolous appeals since 2003, when this Committee concluded that "[t]he payment of taxes upon appeal by the taxpayer *after the first hearing* should be the rule in Hawaii." S.C.R. No. 1633 (Senate Ways and Means), 2003 (emphasis added). Nor does DoTax explain why an appeal from an assessment exceeding $50,000 is more likely to be frivolous than an appeal from an assessment that is less than $50,000. My own experience has been to the contrary – the more grossly DoTax overreaches, the more important it is for a taxpayer to be able to appeal, and the less likely it is that the appeal is frivolous.

The most glaring recent example is the assessments against the online travel companies ("OTCs"), whose appeals from those assessments resulted in the Hawai`i Supreme Court's March 17, 2015 decision in *Travelocity, L.P. v. Director of Taxation*, 135 Haw. 88, 346 P.3d 157 (2015). In that case, in which I was one of the attorneys representing the OTCs, DoTax issued assessments in early 2011, and revised assessments in June 2012, against ten OTCs (and five non-operating holding companies, which DoTax ultimately had to withdraw). As revised, the assessments totaled more than ***one billion dollars*** for TAT, General Excise Tax ("GET"), penalties and interest for the period 2000 through 2011.

The OTCs appealed to the Tax Appeal Court, which they were entitled to do under current law without first paying the billion-dollar assessment. The Tax Appeal Court vacated the $729 million in TAT assessments, but upheld approximately $247 million of the GET assessments based its belief that HRS § 237-18(g) was inapplicable.

Thus, having already had a hearing, the OTCs were required to deposit $247 million in the litigated claims fund in order to appeal from the Tax Appeal Court's decision.

The Hawai'i Supreme Court affirmed the Tax Appeal Court's determination that the OTCs did not owe TAT, and held that, with respect to GET, the amount owed had to be reduced by application of HRS § 237-18(g).[1] Ultimately, the State was required to return to the OTCs their $194 million in "overpayments" to the litigated claims fund, together with $4.78 million in interest for the period from April 2013 through the date of payment in September, 2015. ***The State was allowed to retain $53 million, roughly five percent of the amount assessed.***

DoTax's claim that this bill would have no impact on the general public is disingenuous. Had the OTCs been required to pay the assessments in full before appealing to the Tax Appeal Court (and assuming they were able to do so), the State's interest liability would have been far greater. The State would have been liable for interest on almost a billion dollars (rather than on $194 million) and interest would have started running against the State in February 2011 (rather than in April 2013). Instead of the $4.78 million in interest the State paid to the OTCs, under the provisions of this proposed bill, the interest owed to the OTCs would have been closer to $40 million.

The problem with this bill is that, although purportedly proposed for the purpose of reducing frivolous appeals, it does nothing to deter frivolous assessments, which are potentially a bigger and more costly problem for the State. In the case of the OTCs, even ***after*** the Tax Appeal Court ruled in 2012 that OTCs are not hotel "operators" and do not owe TAT, DoTax issued TAT assessments totaling more than $75 million against the OTCs in 2013, for the 2012 tax year. It has been almost a year since the Hawai'i Supreme Court conclusively determined that TAT does not apply to OTCs, yet DoTax has not withdrawn those assessments. Had the OTCs been required to pay the assessments before appealing in June 2013, the State would be liable for additional interest on that $75 million.

There is simply no basis for concluding that frivolous appeals have become a problem since HRS § 235-114 was amended in 2004 to ensure that every taxpayer had a right to a hearing *before* paying the challenged assessment (and have become a problem particularly with respect to appeals of assessments over $50,000). Requiring taxpayers with large assessments to pay the assessments before appealing does not just deter frivolous appeals, but equally deters meritorious appeals, such as the OTCs' appeals.

With respect to Section 3 of the Bill, I am in strong support of changing the rate of interest the State must pay on overpayments to the litigated claims fund pursuant to HRS § 232-24. As a matter of fundamental fairness, the interest rate the taxpayer receives on an overpayment should be no less than the interest the State receives on underpayments or nonpayment pursuant to HRS § 231-39(b)(4). This is particularly the case if taxpayers will no longer have the right to appeal large assessments before paying

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[1] *Travelocity, supra*, 135 Hawai'i at 127, 113, 346 P.3d at 196, 183.

them, because it will help ensure that DoTax has carefully weighed the merits of the assessment against the cost to the State if the assessment does not withstand appeal.

Sincerely,

Pamela W. Bunn