

TAX FOUNDATION OF HAWAII

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SUBJECT: TAX APPEALS, Procedure for Payments Under Protest when Suit Brought Prematurely

BILL NUMBER: SB 3301

INTRODUCED BY: KOUCHI (Introduced by request of another party)

EXECUTIVE SUMMARY: Clarifies and adds procedural safeguards to section 40-35, HRS, which relates to payments to the State under protest.

SYNOPSIS: Amends section 40-35, HRS, to provide that if a payment under protest suit is brought prematurely and the claimant's suit is dismissed, the claimant's payment may be retained in the litigated claims fund. (1) If the agency subsequently renders a final decision, the claimant may, within thirty days after notice of the decision, refile the action for a refund of the payment that is in the litigated claims fund, whereupon the court shall have jurisdiction over the action; (2) If no action is filed within thirty days after notice of the decision, the payment shall become a government realization; or (3) If the agency has not rendered a final decision within one hundred eighty days after the date of the claimant's payment, the agency shall refund the payment to the claimant with interest the same as if judgment had been rendered for the claimant, and shall certify to the court that it has done so.

Also provides that the interest to be paid is the interest earned on the payment by the litigated claims fund, as opposed to the flat 2% under current law.

EFFECTIVE DATE: Upon approval.

STAFF COMMENTS: *Grace Business Development Corporation v. Kamikawa*, 92 Haw. 608, 994 P.2d 540 (2000), held that if a taxpayer pays money under protest but then sues for a refund before the defendant agency has formally taken a position on whether the money is due, the appeal is to be dismissed. If the agency later decides that the money is indeed due, it is generally too late for the suit to be refiled (it needs to be filed within 30 days after the payment), potentially allowing the agency to keep the money whether or not the payment to the agency was legal. This bill prevents the Catch-22 situation described.

As an example, suppose a taxpayer is being audited. The auditor sends an email to the taxpayer directing him to pay \$10,000 in additional tax. The taxpayer pays the amount with a protest letter and files suit under HRS section 40-35. The Department responds that the auditor's email was not a formal agency determination, and the court dismisses the lawsuit. Assuming that 30 days have passed, under present law it appears that the taxpayer loses the money whether or not the taxpayer would have prevailed on the merits. Under the bill, the taxpayer's money is

retained in the litigated claims fund for 180 days. If a Notice of Final Assessment is then issued, the taxpayer can refile the lawsuit with no additional payment (except for the court filing fee) within 30 days after the Notice. And if the agency does not decide within the 180 days, it must refund the money to the taxpayer; if the agency then issues a final assessment the taxpayer can then pay under protest and sue within 30 days.

The bill changes the interest rate payable when the taxpayer wins from a flat rate of 2% to the actual earnings on the special deposit, following the rule in *Hawaiian Trust Co. v. Smith*, 32 Haw. 38 (1931), where the court held that when the taxpayer wins, the money in the special account is the taxpayer's money and the taxpayer should be entitled to the earnings on it.

Digested: 2/5/2026