

H.B. NO. 2417

A BILL FOR AN ACT

RELATING TO TAX ADMINISTRATION.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. The purpose of this Act is to conform to
2 federal tax law and to provide the department of taxation with
3 the authority to impose civil penalties and seek court
4 injunctions on persons who promote abusive tax shelters and tax
5 return preparers who take unrealistic positions on tax returns.

6 SECTION 2. Chapter 231, Hawaii Revised Statutes, is
7 amended by adding a new section to be appropriately designated
8 and to read as follows:

9 "§231- Understatement of taxpayer's liability by tax
10 return preparer. (a) Any tax return preparer making
11 understatements of liability based upon unrealistic positions on
12 a tax return or claim for tax refund shall pay a penalty of
13 \$250, with respect to each such tax return or claim, unless
14 there is reasonable cause for the understatement and the tax
15 return preparer acted in good faith.

16 (b) A tax return preparer wilfully or recklessly makes an
17 understatement of liability based upon unrealistic positions on
18 a tax return or claim for tax refund if the tax return preparer:

H.B. NO. 2417

1 (1) Wilfully attempts to understate a person's tax
2 liability; or

3 (2) Recklessly disregards any tax law or rule.

4 Any tax return preparer who violates this subsection shall pay a
5 penalty of \$1,000, with respect to each such tax return or
6 claim. Penalties assessed under this subsection shall be
7 reduced by any penalties assessed under subsection (a).

8 (c) For purposes of subsections (a) and (b),
9 understatements of liability using unrealistic positions occur
10 when:

11 (1) Any part of a tax return or claim for tax refund is
12 based on a position that does not have a realistic
13 possibility of being sustained on its merits;

14 (2) Any tax return preparer who prepares a tax return or
15 claim for tax refund knew or reasonably should have
16 known of such an unrealistic position; and

17 (3) The unrealistic position was not a disclosed item as
18 provided in subsection (h) or was frivolous.

19 (d) If within thirty days after the notice and demand of
20 any penalty under subsection (a) or (b) is made, the tax return
21 preparer:

1 (1) Pays an amount that is not less than fifteen per cent
2 of the penalty amount; and

3 (2) Files a claim for refund of the amount so paid,
4 no action to levy or file a proceeding in court to collect the
5 remainder of the penalty shall be commenced except in accordance
6 with subsection (e).

7 (e) An action that is stayed pursuant to subsection (d)
8 may be brought thirty days after either of the following events,
9 whichever occurs first:

10 (1) The tax return preparer fails to file an appeal to the
11 tax appeal court within thirty days after the day on
12 which the claim for refund of any partial payment of
13 any penalty under subsection (a) or (b) is denied; or

14 (2) The tax return preparer fails to file an appeal to the
15 tax appeal court for the determination of the tax
16 return preparer's liability for the penalty assessed
17 under subsection (a) or (b) within six months after
18 the day on which the claim for refund was filed.

19 Nothing in this subsection shall be construed to prohibit any
20 counterclaim for the remainder of the penalty in any proceeding.

21 (f) If there is a final administrative determination or a
22 final judicial decision that the penalty assessed under

1 subsection (a) or (b) should not apply, then that portion of the
2 penalty assessed shall be voided. Any portion of the penalty
3 that has been paid shall be refunded to the tax return preparer
4 as an overpayment of tax without regard to any period of
5 limitations which, but for this subsection, would apply to the
6 making of the refund.

7 (g) At the request of the director of taxation, a civil
8 action may be brought to enjoin a tax return preparer from
9 further acting as a tax return preparer or from engaging in
10 conduct prohibited under subsection (a) or (b) as follows:

11 (1) Any action under this subsection may be brought in the
12 circuit court of the circuit in which the tax return
13 preparer resides or has a principal place of business,
14 or in which the taxpayer with respect to whose tax
15 return the action is brought resides;

16 (2) The court may exercise its jurisdiction over the
17 action separate and apart from any other action
18 brought by the State against the tax return preparer
19 or taxpayer;

20 (3) If the court finds that a tax return preparer has
21 engaged in conduct subject to penalty under subsection
22 (a) or (b) and that injunctive relief is appropriate

1 to prevent the recurrence of that conduct, the court
2 may enjoin the preparer accordingly; and

3 (4) If the court finds that a tax return preparer has
4 continually or repeatedly engaged in conduct
5 prohibited under subsection (a) or (b) and that an
6 injunction prohibiting that conduct would not be
7 sufficient to prevent the preparer's interference with
8 the proper administration of this chapter, the court
9 may enjoin the preparer from acting as a tax return
10 preparer.

11 (h) For purposes of this section:

12 "Disclosed item" means any item where:

- 13 (1) The relevant facts affecting the item's tax treatment
14 are adequately disclosed in a tax return or in a
15 statement attached to a tax return; and
16 (2) There is a reasonable basis for the tax treatment of
17 the item by the taxpayer.

18 "Tax return preparer" means any person who prepares,
19 employs, or supervises one or more persons who prepare a tax
20 return or a claim for tax refund. Preparation of a substantial
21 portion of a tax return or claim for tax refund shall be treated

1 as if it were the preparation of a tax return or claim for tax
2 refund.

3 "Understatement of liability" means any understatement of
4 the net amount payable for any tax imposed or any overstatement
5 of the net amount creditable or refundable for any tax. Except
6 as otherwise provided in subsection (f), the determination of
7 whether there is an understatement of liability shall be made
8 without regard to any administrative or judicial action
9 involving the taxpayer.

10 (i) The penalty imposed by this section shall be in
11 addition to any other penalty provided by law."

12 SECTION 2. Chapter 231, Hawaii Revised Statutes, is
13 amended by adding a new section to be appropriately designated
14 and to read as follows:

15 "§231- Promoting abusive tax shelters. (a) A person
16 promotes an abusive tax shelter by:

17 (1) Organizing or assisting in the organization of:

18 (A) A partnership or other entity;

19 (B) Any investment plan or arrangement; or

20 (C) Any other plan or arrangement; and

21 (2) Directly or indirectly participating in the sale of
22 any interest in an entity under paragraph (1),

1 to make or furnish or cause another person to make or furnish
2 (in connection with an organization or sale) a statement with
3 respect to: whether any deduction or credit is allowed, whether
4 any income may be excluded, or the securing of any other tax
5 benefit by reason of holding an interest in the entity or
6 participating in the plan or arrangement that the person knows
7 or has reason to know is false or fraudulent or is a gross
8 valuation overstatement as to any material matter.

9 (b) A person found promoting an abusive tax shelter shall
10 pay, with respect to each activity described in subsection (a),
11 a penalty of \$1,000 or, if the person establishes that it is
12 less, one hundred per cent of the gross income derived or to be
13 derived by the person from the activity. For purposes of this
14 section, activities described in subsection (a)(1) shall be
15 treated as a separate activity for each entity or arrangement.
16 Participation in each sale described in subsection (a)(2) shall
17 be treated as a separate activity for each entity or
18 arrangement.

19 (c) At the request of the director, a civil action may be
20 brought to enjoin any person described in subsection (a) from
21 engaging in any conduct described in subsection (a). Any action
22 under this section shall be brought in the circuit court of the

1 circuit where the person in subsection (a) resides or where the
2 person's principal place of business is located. The court may
3 exercise its jurisdiction over the action separate and apart
4 from any other action brought by the State against those persons
5 described in subsection (a). If the court finds that a person
6 described in subsection (a) has engaged in any conduct subject
7 to penalty under subsection (b) and that injunctive relief is
8 appropriate to prevent the recurrence of that conduct, the court
9 may enjoin the person accordingly.

10 (d) For purposes of this section, "gross valuation
11 overstatement" means any statement of value for any property or
12 services if:

- 13 (1) The value so stated exceeds two hundred per cent of
14 the amount determined to be the correct valuation; and
15 (2) The value of the property or services is directly
16 related to the amount of any deduction or credit
17 allowable to any participant.

18 (e) The director may waive all or any part of the penalty
19 provided by subsection (b) with respect to any gross valuation
20 overstatement on a showing that there was a reasonable basis for
21 the valuation and that the valuation was made in good faith.

JUSTIFICATION SHEET

DEPARTMENT: Taxation

TITLE: A BILL FOR AN ACT RELATING TO TAX ADMINISTRATION.

PURPOSE: To conform to federal tax law and to provide the Department of Taxation with the authority to impose civil penalties and seek court injunctions on persons who promote abusive tax shelters and tax preparers who support unrealistic positions on tax returns.

MEANS: Add two new sections to chapter 231, Hawaii Revised Statutes.

JUSTIFICATION: A. Tax Return Preparer

The overall duty of a preparer is to prepare a proper return. The preparer can generally rely in good faith on information furnished by the taxpayer without verification. The preparer is not required to audit, examine, or review books and records, business operations, documents, or other evidence in order to verify independently the taxpayer's information.

The preparer, however, cannot ignore the implications of information furnished to or actually known by the preparer. If the information furnished, appears to be incorrect or incomplete, the preparer must make reasonable additional inquiries.

In addition, the preparer must make appropriate inquiries to determine whether the taxpayer has the substantiation required for certain deductions (e.g., travel and entertainment expenses).

This bill imposes penalties of \$250 for an undisclosed, unrealistic position, and \$1000 for a willful or reckless disregard of the rules. The Department may also seek injunctive relief to prevent certain recurring conduct. These penalties are drawn from Internal Revenue Code (IRC) sections 6694 and 7407.

B. Promoting abusive tax shelters

This bill proposes another penalty and injunctive relief (drawn from IRC sections 6700 and 7407) that apply to two distinct types of conduct: (1) making a false statement; and (2) making a "gross valuation overstatement."

The penalty is applicable to any "person" who, directly or indirectly, organizes or assists in the organization of a tax shelter or who participates in the sale of any interests in a shelter. Although the penalty is aimed at individuals organizing and marketing interests in limited partnership tax shelters, the coverage is much broader. Any person--an individual, a corporation, a partnership, a trust, or an estate--can be a promoter. The tax shelter may be in the form of any entity, plan, or arrangement from which a tax benefit may be derived. Moreover, the plan or arrangement need not be an investment; it can include other activities, such as the sale of mail-order ministries or family trust arrangements.

Impact on the public: The penalties will require preparers to be more diligent in return preparation and deter the promotion of abusive tax shelters.

Impact on the department and other agencies: The proposed sections will provide the department with authority to impose civil penalties and injunctions on certain

preparers and promoters. The revisions to certain assessment sections should enable the department to assess and levy more efficiently and effectively.

GENERAL FUND: Minimal.

OTHER FUNDS: None.

PPBS PROGRAM
DESIGNATION: TAX 102.

OTHER AFFECTED
AGENCIES: None.

EFFECTIVE DATE: July 1, 2006.