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LT. GOVERNOR



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DIRECTOR OF TAXATION

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DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
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HOUSE COMMITTEE ON JUDICIARY

TESTIMONY REGARDING SB 711 RELATING TO TAXATION

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

DATE: MARCH 11, 2008

TIME: 2:00PM

ROOM: 325

This bill proposes to create a 10-year statute of limitations for collection of various taxes. This bill also seeks to clarify tax law to provide a three-year statute of limitations for assessment on general excise, use, and other periodic returns, by providing for the limitations period to begin upon the filing of the earliest respective periodic return.

The Department of Taxation (Department) **opposes** this legislation and recommends the Committee hold this measure.

I. PROPOSED 10-YEAR STATUTE OF LIMITATIONS

This legislation will greatly impact the Department's ability to levy and collect unpaid taxes. Presently, the Department is entitled to an unlimited statute of limitations for uncollected taxes, which provides a material benefit to the general fund.

The Department is opposed to amending Hawaii tax law to provide for a collection statute of limitations of 10 years. Proponents of such an amendment argue that the ability to substantiate return information and collection issues erodes over time. The Department does not contend that a 10-year statute of limitations is unreasonable, only that the argument that collection actions 20 to 25 years after assessment and the taxpayer's lack of substantiating documents is of little difference compared to 10 years. The Department prefers the unlimited statute of limitations because it is possible for a taxpayer to be unable to pay the assessed tax for several years and, after time, later become solvent to the extent that full recovery of taxes owed is possible.

Especially with regard to larger tax liabilities, it may take decades for a taxpayer to accumulate sufficient wealth to be able to pay their tax bill. Similarly, with regard to businesses, the Department suggests that by forcing the Department to levy and collect within 10 years likely hampers a business' ability to be profitable and generate revenues over time and later have the ability

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to settle any outstanding liabilities. By being required to collect within 10 years (thus taking revenues that would otherwise be invested in business operations) minimizes a business' ability to retain earnings and reinvest in business operations for future sustained profitability. The Department will be forced to pursue more foreclosures and seizures of businesses to comply with the 10-year statute thereby resulting in the closure of those businesses, rather than the Department working with those businesses to pay the tax.

II. THREE-YEAR STATUTE OF LIMITATIONS ON ASSESSMENT ON PERIODIC RETURNS

The Department opposes this suggestion. The law clearly requires all taxpayers subject to various periodic tax return liabilities to file an annual reconciliation return. It is an unacceptable argument to claim that it is "not fair" for the statute of limitations to toll if a taxpayer "forgot" to file the annual return after diligently filing the periodic requirement.

Tax law is clear and the Department's forms and instructions aid taxpayers by setting forth the requirements of the general excise tax filing requirements. Just as the federal government begins the statute of limitations for income tax returns at the date due or when filed, whichever is later; the Department likewise believes it is justified in beginning the running of the statute of limitations when a taxpayer's obligations under the law are closed upon the filing of the annual reconciliation and not earlier.

For the reasons set forth herein, the Department respectfully requests that the Committee hold this measure because this legislation could adversely impact revenue collections and ultimately impact the general fund.

III. CRITICAL NEED FOR COMMITTEE TO CONSIDER REVENUE LOSS; CONSIDER ADOPTING OFFSETS TO REVENUE LOSS; AND OTHER TOLLING PROVISIONS FOR STATUTES OF LIMITATIONS

Assuming the Committee is inclined to pass this measure out of committee for further discussion, the Department raises three important issues for the Committee's consideration:

REVENUE LOSS IS LARGE—This legislation could result in revenue loss of approximately \$50 million per year. During a time where some consider the fiscal outlook of the State tight, it is important to factor in the substantial revenue loss posed by this bill.

OFFSETS ARE CRITICAL—Given the potentially large revenue loss, the Department suggests that the Committee strongly follow Congress' lead by passing revenue loss legislation with offsetting revenue gain legislation. To accomplish this net-neutral outcome, the Department strongly suggests that the Committee amend this measure to comprehensively adopt 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 § 6695A Substantial or Gross Valuation Misstatement Penalty**
- **IRC § 6700 Abusive Tax Shelter Promoter Penalty**
- **IRC § 6701 Aiding and Abetting Understatement Penalty**
- **IRC § 6702 Frivolous Submission 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. There is no reason for there to be substantially differing "playing fields," and, until such a reconciliation, the Department suggests this be bill held until such penalties are instituted to offset the revenue loss from this measure.

THE STATUTE OF LIMITATIONS MUST TOLL SIMILAR TO THE FEDERAL STATUTE—According to the Committee Reports on this measure, the intent appears to be to conform to the federal 10-year statute of limitations. If this is the legislative will, the bill must be amended to include the tolling features that the IRS has at its disposal in order to ensure proper revenue collection. The statute of limitations must be amended to toll during the following events, as provided under § 6502, IRC:

- **Where the taxpayer and government agree to toll the statute;**
- **Where the taxpayer is bankrupt and later able to be recovered against; and**
- **Where the government is able to reduce the tax debt to a judgment and pursue the debt through judicial channels.**



**The Chamber of
Commerce of Hawaii**

Since 1850

Testimony to the House Committee on Judiciary
Tuesday, March 11, 2008 at 2:00 p.m.
Room 325, State Capitol

RE: S.B. 711 Relating to Taxation

Chair Waters, Vice Chair Blake K. Oshiro, and Members of the Committees:

My name is Jim Tollefson, President and CEO of The Chamber of Commerce of Hawaii. The Chamber of Commerce of Hawaii supports Senate Bill 711.

The Chamber is the largest business organization in Hawaii, representing over 1100 businesses. Approximately 80% of our members are small businesses with less than 20 employees. 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.

We urge your support of this measure, which: (1) imposes a 10-year statute of limitations on tax collections (Hawaii has no statute of limitations on collections); (2) starts the running of the statute of limitations on assessments from the filing of the earlier of the filing of the periodic or annual returns, not just the annual return as under current law.

(1) Conform Hawaii's statute of limitations on collections of delinquent taxes to that of the federal government's 10 years. Under current law, Hawaii has no statute of limitations on collections, which means that the Department of Taxation can pursue a taxpayer until death or dissolution/bankruptcy. Ten years from the date of assessment, which is the federal government's statute of limitations on collections, should be enough time for the Department to act and collect delinquent taxes, and would ensure some measure of urgency in collecting delinquent taxes. Taxpayers would also be assured that they can have a fresh start after a period of time. We note that Hawaii is one of only four states that provide for no statute of limitations on collections.

(2) The three-year statute of limitations on assessment of the GET and other periodic returns should not run only from the filing of the annual reconciliation return. Time and again taxpayers who have filed their periodic returns (monthly, quarterly, semi-annually) on time with full payment of taxes owed are unaware that they must also file the annual reconciliation return due the following April 20 even though no additional tax is owed for the year. Under current law, the three-year statute of limitations only begins to run from the filing of this annual return no matter that all periodic returns were filed and taxes paid, giving the Department the power to assess taxes that can go back far more than three years. This bill requires that the three-year statute of limitations starts to run from the filing of each periodic return or the annual return, whichever is earlier.

Thank you for the opportunity to submit testimony.

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ANDREW V. BEAMAN
ANDREW R. BUNN
ANDREW W. CHAR
LEROY E. COLOMBE
RAY K. KAMIKAWA
ALLEN H. SAKAI
DANTON S. WONG

ANNE E. LOPEZ
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JOSHUA A. WISCH
ADRIENNE S. YOSHIHARA

CHUN, KERR, DODD, BEAMAN & WONG

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GEORGE L. T. KERR
1933-1998
GREGORY P. CONLAN
1945-1991

THE HOUSE THE TWENTY-FOURTH LEGISLATURE REGULAR SESSION OF 2008

COMMITTEE ON JUDICIARY

Hearing March 11, 2008
Testimony on SB 711

(Relating to Taxation)

Chair Waters, Vice-Chair Oshiro, members of the Committee:

We urge your support of this measure, which: (1) imposes a 10-year statute of limitations on tax collections (Hawaii has no statute of limitations on collections); (2) starts the running of the statute of limitations on assessments from the filing of the earlier of the filing of the periodic or annual returns, not just the annual return as under current law.

(1) Conform Hawaii's statute of limitations on collections of delinquent taxes to that of the federal government's 10 years. Under current law, Hawaii has no statute of limitations on collections, which means that the Department of Taxation can pursue a taxpayer until death or dissolution/bankruptcy. Ten years from the date of assessment, which is the federal government's statute of limitations on collections, should be enough time for the Department to act and collect delinquent taxes, and would ensure some measure of urgency in collecting delinquent taxes. Taxpayers would also be assured that they can have a fresh start after a period of time. We note that Hawaii is one of only four states that provide for no statute of limitations on collections. Please see attached survey of states' statutes of limitations on collections.

(2) The three-year statute of limitations on assessment of the GET and other periodic returns should not run only from the filing of the annual reconciliation return. Time and again taxpayers who have filed their periodic returns (monthly, quarterly, semi-annually) on time with full payment of taxes owed are unaware that they must also file the annual reconciliation return due the following April 20 even though no additional tax is owed for the year. Under current law, the three-year statute of limitations only begins to run from the filing of this annual return no matter that all periodic returns were filed and taxes paid, giving the Department the power to assess taxes that can go back far more than three years. This bill requires that the three-year statute of limitations starts to run from the filing of each periodic return or the annual return, whichever is earlier.

Note: because this bill is a carryover from the 2007 regular session, effective date references to the year 2007 throughout the bill should be changed to 2008.

Very truly yours,

CHUN, KERR, DODD, BEAMAN & WONG,
a Limited Liability Law Partnership



Ray Kamikawa

Statutes of Limitation on the Collection of Income Tax in the Various States

<u>STATE</u>	<u>AUTHORITY</u>	<u>LIMITATION</u> (in years)
Alabama	Code of Ala. § 40-29-51	10
Alaska*	Alaska Stat. § 43.05.270	6
Arizona	ARS § 42-1201	6
Arkansas	ACA § 26-18-306	10
California	Cal. Rev. & Tax Code §19371	10
Colorado	CRS § 39-21-107	6
Connecticut	Conn. Gen. Stat. § 12-35(a)	10
Delaware	30 Del. C. § 553	10
District of Columbia	D.C. Code § 47-4302	10
Florida*	Fla. Stat. § 95.091	20
Georgia	OCGA § 48-3-21	7
Hawaii	none	None
Idaho	Idaho Code § 63-3068	6
Illinois	35 ILCS 5/1101-1104	3; 20 if notice filed
Indiana	Ind. Code § 6-8.1-8-2	10; state can extend 10 more
Iowa	Iowa Code Ann. § 422.26	10
Kansas	KSA § 79-3230	3
Kentucky	KRS § 140.160	10
Louisiana	La. R.S. § 47:1577	none
Maine	36 MRS § 174	6
Maryland	Md. Code Ann., Tax-General § 13-1103	7
Massachusetts	ALM GL ch. 62C, § 65	6
Michigan	MCLS § 205.29	7; state can extend 7 more
Minnesota	Minn. Stat. § 270C.63	10
Mississippi	Phone call to MS state tax commission	none
Missouri	§ 143.902 R.S. Mo.	10
Montana	Mont. Code. Anno. § 15-1-701	10
Nebraska	R.R.S. Neb. § 77-3904	3; 10 if notice filed
Nevada*	Nev. Rev. Stat. Ann. § 360.473	5; state can extend 5 more
New Hampshire**	RSA § 80:19	1
New Jersey	N.J. Stat. § 54A:9-12	6
New Mexico	N.M. Stat. § 7-1-19	10
New York	NY CLS Tax § 692	6
North Carolina	N.C. Gen. Stat. § 105-242	10
North Dakota	N.D. Cent. Code § 57-38-48	none
Ohio	HB 390, signed into law 6/28/06	4
Oklahoma	68 Okl. Stat. § 223	10
Oregon	ORS § 305.155	7
Pennsylvania	61 Pa. Code § 119.11	5; state can extend
Rhode Island	R.I. Gen. Law § 44-30-92	3
South Carolina	S.C. Code Ann. § 12-54-120	10

South Dakota*	S.D. Codified Law § 10-59-16	3
Tennessee**	Tenn. Code Ann. § 67-1-1429	6; state can extend
Texas*	Tex. Tax Code § 111.202	3
Utah	Utah Code Ann. § 59-7-520	3
Vermont	32 V.S.A. § 5892	6
Virginia	Va. Code Ann. § 58.1-1802.1	20
Washington*	Rev. Wa. Code § 82.32.210; § 6.17.020	10
West Virginia	W. Va. Code § 11.10.16	10
Wisconsin	Wis. Stat. § 71.91	20
Wyoming*	Wyo. Stat. § 39-15-110	3

* These states do not tax income; the statutes of limitations listed are for the collection of sales, excise, use and other state taxes.

** These states impose income tax only on dividend and interest income.

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H S C P A

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March 10, 2008

Honorable Rep. Tommy Waters, Chair
Committee on Judiciary
Hawaii State Capital, Room 325
415 South Beretania Street
Honolulu, Hawaii 96813

RE: Hearing March 11, 2008 Senate Bill 711 – Relating to Taxation

Dear Chair Waters, Vice-Chair Oshiro, Members of Committee:

On behalf of the Hawaii Society of Certified Public Accountants (HSCPA) Tax Committee, I am writing to ask for your support for SB 711 which is equitable and ultimately revenue neutral.

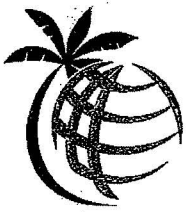
Intent of the Proposed Legislation

- Impose a 10-year statute of limitations on tax collections which is equivalent to the federal tax law since Hawaii has no statute of limitations on collections; and
- Start the running of the three-year statute of limitations on assessments from the filing of the periodic general excise and use tax, not just the annual return.

Rationale for the Proposed Legislation

- Establish and conform Hawaii's statute of limitations on collections to the ten years established by the federal government. Under current law, Hawaii has no statute of limitations on collection of assessed taxes, which means Hawaii can pursue a taxpayer forever on collections short of bankruptcy. Also, the ten years statute of limitation collection period will provide the Department of Taxation with an incentive to expedite collection efforts which ultimately benefits the State since the value of a receivable diminishes with time.
- The three year statute of limitations on assessment of the general excise tax and use tax should not run from the filing of the annual reconciliation return. Often time taxpayers who have reported and paid their taxes with the periodic returns (monthly, quarterly, semi-annually) were unaware that they needed to also file their annual reconciliation return to start the three year statute of limitations on assessment. This is true no matter whether they properly reported and paid the taxes due on their periodic returns since their

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H S C P A

Hawaii Society of
Certified Public Accountants

failure to file the annual reconciliation, the taxpayers are treated as if no returns were filed for that year. This is a trap for the unwary, because all taxpayers do not appreciate the necessity of filing the annual reconciliation return, if all taxes have been properly reported on the periodic returns. The solution is to have the three-year statute of limitations begin to run for each periodic return filed, so that assessments are made by reporting period rather than annually.

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Passage of Senate Bill 711 will promote fairness and simplification for the people of Hawaii and enhance administration and collection of tax by the Department of Taxation.

Very truly yours,

Jessica S. Swanson, CPA
Chair of Tax Committee

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**THE HOUSE
THE TWENTY-FOURTH LEGISLATURE
REGULAR SESSION OF 2008**

COMMITTEE ON JUDICIARY

Hearing March 11, 2008, Testimony on SB 711

(Relating to Taxation)

Chair Waters, Vice-Chair Oshiro and Members of the Committee:

We are writing to request your support for SB 711, which: (1) establishes a ten year statute of limitations on tax collections since Hawaii has no statute of limitations on collections; and (2) allows the statute of limitations on assessments from the filing of the earlier of the filing of the periodic or annual returns, not just the annual return as under current law.

We believe that SB 711 is fair and equitable, irrespective of the potential lost in tax revenues, which are possibly significantly overstated by the Department of Taxation for the following reasons:

- The ten year statutes of limitation on collections is more than a reasonable time in which the Department of Taxation has to pursue collection actions, which economically diminishes with time. Would encourage the Department of Taxation to more aggressively pursue collection actions and enable to State to secure funds to carryout its purpose in a timelier manner. Have Hawaii collection statute of limitations for collections conform with federal law, and be compatible with most other states.
- The three yeas statute of limitation on the assessment of general excise tax and other periodic returns should not run only from the filing of the annual reconciliation return but when such returns are filed. The current three year statute of limitations which only begins to run from the filing of the annual return is a trap for the unwary. Furthermore, this revision in the current law should not significantly impact the Department of Taxation's ability to administer and fulfill its revenue generating function.

Thank you for allowing us to submit written testimony on SB 711.

Very truly yours,

A handwritten signature in black ink, appearing to read "Howard K. Kam Jr.", written over a horizontal line.

Howard K. Kam Jr.
Its Managing Director

000260

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, GENERAL EXCISE, TRANSIENT ACCOMMODATION, FUEL, CONVEYANCE, RENTAL MOTOR VEHICLE AND TOUR VEHICLE SURCHARGE, INSURANCE PREMIUMS, MISC., Statute of limitations

BILL NUMBER: SB 711

INTRODUCED BY: Fukunaga and 4 Democrats

BRIEF SUMMARY: Amends HRS chapters 235-111, 237-40, 237D-9, 243-14, 247-6.5, 251-8, 346E-6, and 431:7-204.6 to provide that the statute of limitations for the collection of any assessment of tax shall be within ten years after the assessment. Stipulates that any tax assessed prior to July 1, 2007, the levy or proceeding shall be barred after June 30, 2017.

The three-year statute of limitations on tax assessments for general excise and transient accommodation taxes begins running from the filing of each periodic return.

The provisions relating to the statute of limitations for periodic tax returns shall be effective for tax returns filed after June 30, 2007.

EFFECTIVE DATE: July 1, 2007

STAFF COMMENTS: The proposed measure would extend the limitation period for the collection of taxes to ten years from the date of any assessment of tax.

Generally, the statute of limitations for the assessment, levy, collection or credit or refund under the income tax law is three years from the due date prescribed for the filing of a return. For cases involving a fraudulent, false return or no return with the intent of evading tax or liability, there is no statute of limitations.

It should be noted that the legislature by Act 274, SLH 1969, reduced the statute of limitations for the assessment, levy, collection, or credit or refund of taxes from five to three years to conform to the federal Internal Revenue Code (IRC). Since that time, congress imposed a limit on how long the Service can take to collect on the assessment made against a taxpayer. It reasoned that if the Service did not make an effort in an expeditious manner, the taxpayer should not be held liable for the assessment beyond a reasonable period of time. In this case, the statute to collect on an assessment made by the Service and in this case the tax department should be limited to ten years, giving the taxpayer some sense of closure. It will also encourage the department to follow up on collection of an assessment and not let it run indefinitely. Thus, this measure proposes to conform to the federal statute of limitation provisions.

Digested 3/7/08

PETER L. FRITZ
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**HOUSE OF REPRESENTATIVES
THE TWENTY-FOURTH LEGISLATURE
REGULAR SESSION OF 2008**

**COMMITTEE ON THE JUDICIARY
Hearing March 11, 2008
Testimony on SB 711
(Relating to Taxation)**

Chair Waters, Vice-Chair Oshiro, members of the Committee:

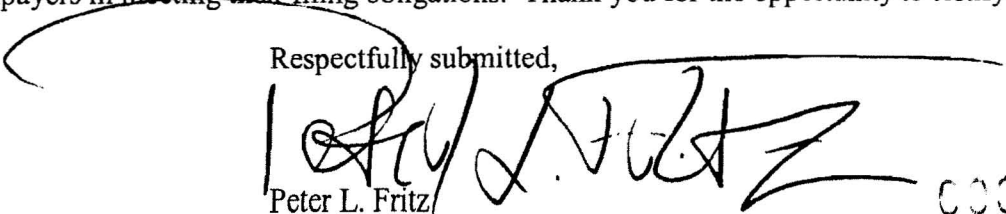
My name is Peter Fritz. I am an attorney specializing in tax law and a former Administrative Rules Specialist with the Department of Taxation. This bill (1) imposes a 10-year statute of limitations on tax collections (Hawaii has no statute of limitations on collections) and (2) starts the running of the statute of limitations on assessments from the filing of the earlier of the filing of the periodic or annual returns, not just the annual return as under current law. I support this bill.

(1) Hawaii's statute of limitations on collections of delinquent taxes should be the same as the federal government's 10 years. Under current law, Hawaii has no statute of limitations on collections, which means that the Department of Taxation can pursue a taxpayer until death or dissolution/bankruptcy. This imposes an unfair burden for taxpayers with respect to maintaining records to prove payment of taxes. Ten years from the date of assessment, which is the federal government's statute of limitations on collections, should be enough time for the Department to act and collect delinquent taxes. It would ensure some sense of urgency in collecting delinquent taxes. Taxpayers would also be assured that they can have a fresh start after a period of time. This bill establishes a ten-year statute of limitations on tax collection.

(2) The three-year statute of limitations on assessment of the GET and other periodic returns should not run only from the filing of the annual reconciliation GET return. Under current law, the three-year statute of limitations only begins to run from the filing of this annual return no matter that all periodic returns and taxes were paid, giving the Department time the power to assess taxes that can go back far more than three years. It is unfair to say that the statute of limitations never started running (and thus stays open forever) when a taxpayer filed all twelve monthly returns on time, but forgot to file the annual reconciliation form. In particular, mainland taxpayers who are not familiar with Hawaii taxes fall into this trap. They file every month, honestly reporting their tax liability and sincerely believing they've done what they're supposed to do. Then, 8 or 10 or 12 years later, they are told they are still open to audit because they didn't file the annual reconciliation form. This bill requires that the three-year statute of limitations starts to run from the filing of each periodic return or the annual return, whichever is earlier.

The provisions in this bill will provide needed conformity with federal law and ensure clarity for Hawaii's taxpayers in meeting their filing obligations. Thank you for the opportunity to testify.

Respectfully submitted,


Peter L. Fritz

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RICHARD PAUL McCLELLAN III
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THE HOUSE
THE TWENTY-FOURTH LEGISLATURE
REGULAR SESSION OF 2008

COMMITTEE ON JUDICIARY

Hearing March 11, 2008
Testimony on SB 711

(Relating to Taxation)

Chair Waters, Vice-Chair Oshiro, members of the Committee:

I urge you to support this measure.

The purpose of this bill is to correct an apparent oversight in Hawaii's income (and other) tax law for the benefit of Hawaii's taxpayers.

As Honorable Members are aware, statutes of limitation serve a valuable purpose in protecting persons from stale claims and providing certainty of outcomes, among other beneficial aspects.

Honorable Members should be advised that the 10 year statute of limitations only starts upon "assessment." "Assessment" is a carefully defined term in existing law and generally means the filing of the appropriate return or the culmination of an audit, examination, or Department of Taxation assessment procedure.

Persons that do not file their tax returns will not be protected by this measure. This measure in no manner provides a "free ride" or windfall for persons operating "off the books" and not participating in the tax system.

Sincerely,



Richard McClellan

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