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 1584
RELATING TO RATE OF INTEREST APPLICABLE TO OVERPAYMENTS OF TAX

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 26, 2009
TIME: 11AM
ROOM: 308

This measure modifies the interest payable to overpayments of tax from approximately 8% per year to 4% per year.

The Department of Taxation (Department) **supports this legislation as a means of protecting the State's financial interests** in these current economic times, as well as conforming to similar federal practices.

CURRENT SYSTEM TREATS OVERPAYMENTS EQUALLY—Under current law, interest at the approximate rate of 8% per year (two-thirds of one per cent per month or fraction thereof), is assessed by the government for underpayments of tax. This amount per year is also charged against the government for refunds on overpayments of tax. The existing framework treats underpayments and overpayments of tax, and the inherent time value of money intrinsic therein, equally.

TAXPAYER SHOULD BE REPORTING THE PROPER AMOUNT, NOT BEING REWARDED FOR PAYING MORE—With a tax system based upon self-assessment, taxpayers are required to report and pay over the correct amount of tax and no more. Where a tax system provides for interest on overpayments at a rate more competitive than can be obtained in the open financial markets, a taxpayer can intentionally overpay taxes and subsequently request a refund, including 8% interest. Thus, a taxpayer can receive a better return on investment by overpaying their taxes than otherwise available from a local bank. Current interest rates are well below 4% for time deposits or other passive investments. Where a taxpayer can overpay their tax and obtain twice the market rate of interest, the government begins losing substantial sums from the general fund when obligated to pay the rate twice what the government can likely earn in the money market. The interest rate component of a tax system is not intended to reward persons that overpay their tax, but rather ensure proper and timely payment.

OTHER JURISDICTIONS HAVE MODIFIED OVERPAYMENTS RATES—The Department points out that the Internal Revenue Service and California, for example, have lower interest rates for overpayments of tax. Though these jurisdictions apply the lower overpayment rate only to corporations, the Department prefers that this measure lowers the overpayment rate for all taxpayers. This bill provides uniformity and fairness in application of the lower rate and acknowledges the premise that taxpayers should not be rewarded for overpaying their tax, especially with a fixed statutory interest rate as high as Hawaii's.

Below are California's current interest rates—

Previous interest, estimate penalty, and corporation overpayment rates

From	To	Interest rate	Corporation Overpayments
January 1, 2009	June 30, 2009	5%	2%
July 1, 2008	December 31, 2008	7%	3%
January 1, 2007	June 30, 2008	8%	5%
July 1, 2006	December 31, 2006	7%	4%
January 1, 2006	June 30, 2006	6%	3%
July 1, 2005	December 31, 2005	5%	2%
July 1, 2004	June 30, 2005	4%	1%
July 1, 2003	June 30, 2004	5%	1%
July 1, 2002	June 30, 2003	6%	2%
January 1, 2002	June 30, 2002	7%	1%
January 1, 2001	December 31, 2001	9%	1%
January 1, 2000	December 31, 2000	8%	1%
July 1, 1999	December 31, 1999	7%	2%
January 1, 1999	June 30, 1999	8%	2%

CONSIDER A DELAYED EFFECTIVE DATE—The Department appreciates the effective date applying to claims for refund starting January 1, 2009. However, the Department is concerned with computer modification issues that will arise during tax season and raises that issue for the committee. It is doubtful that the Department will be able to retrieve any interest paid on refund claims before the enactment of this bill.

REVENUE GAIN—The Department supports this measure because it also protects the State's financial interests by ensuring that the government only has to pay out a rate that the government should be able to obtain in the money market. Rather than lose money by paying interest under current law, the government can at least theoretically break-even.

This legislation will results in a revenue gain of $2.7 million per year.

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: ADMINISTRATION, Rate of interest on overpayments

BILL NUMBER: SB 1327; HB 1584 (Identical)

INTRODUCED BY: SB by Hanabusa by request; HB by Say

BRIEF SUMMARY: Amends HRS section 231-23(d) to reduce the amount of interest payable on any overpayment of tax from two-thirds of one percent each month or fraction thereof, to one-third of one percent for each month or fraction thereof.

EFFECTIVE DATE: Upon approval; applicable to claims for refund made on or after January 1, 2009

STAFF COMMENTS: Currently, refunds for overpayments of tax are paid with interest of two-thirds of one percent. The proposed measure would reduce the rate to one-third of one percent, perhaps as a reflection of the current state of the economy.

While this measure proposes to reduce the rate of interest for over payments of taxes, to be fair, similar treatment should be afforded to interest on underpayments of state taxes as provided for under HRS section 321-39. It should be noted that the rate of interest paid on overpayments and underpayments has not been adjusted since 1967. During the early 1980 's when the cost of money fluctuated wildly reaching in some cases as high as 22%, it made sense to the taxpayer to perhaps consider deferring the payment of state taxes on which 8% would be due and either paying their federal taxes first or utilizing the funds to invest at higher interest rates. Similarly, in times like these it might make sense for state government to enforce the collection of delinquent taxes sooner as interest on those underpayments would accrue at 8% which is higher than could be realized by early collection and placing that money in financial institutions paying less than 1% interest.

On the federal level, Congress has twice amended the process for determining the interest due on underpayments and overpayments of taxes. Beginning in 1983, the federal interest rate was adjusted semi-annually and compounded daily with the interest rate tied to the average adjusted prime rate charged by commercial banks during the six-month period ending September 30th and March 31st with the new rate becoming effective on January 1st and July 1st respectively.

Although this determination of the adjusted interest rate may seem complex, it should be noted that if Hawaii adopted this identical methodology, the rates would already be calculated by the U.S. Treasury Department which not only determines the rate but prints tables of how much is due for each day of delinquency for whatever amount is due. Therefore, the amount of interest due could easily be determined by the local tax officials.

While an interest rate higher than the current 8% may seem punitive, should market rates rise above the current statutory rate, it acts as an incentive for both the taxpayer and the department to pay taxes due or make refunds on a timely basis. Many taxpayers have noted the Internal Revenue Service has expedited refunds in order to avoid paying interest on overpayments while the Service has reported an increase in the percentage of returns being filed on time.

Thus tying the interest rate on overpayments and underpayments of state taxes insures that the rate charged is a more realistic reflection of current market conditions. Thus, there would be no advantage to the taxpayer nor to the state tax collectors to not pay or refund taxes on a timely basis as there would be no spread between a fixed statutory rate and current market interest rates.

Digested 2/3/09