SB 1327

L E G I S L A T I V E

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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