

---

---

A BILL FOR AN ACT

RELATING TO TAX ADMINISTRATION.

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

1 SECTION 1. As a self-reporting system that relies upon the  
2 honesty and integrity of taxpayers, enforcement of Hawaii's tax  
3 laws is only as effective as the compliance tools that exist to  
4 deter dishonest conduct. Hawaii lacks a vast majority of the  
5 tools used by the Internal Revenue Service to ensure optimal  
6 compliance and deter tax frauds.

7 The purpose of this Act is to amend title 14, Hawaii  
8 Revised Statutes, to conform Hawaii tax administration  
9 provisions to the Internal Revenue Code.

10 PART I. TAX ADMINISTRATION ENFORCEMENT

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

14 "§231-A Understatement of taxpayer's liability by tax  
15 return preparer. (a) Any tax return preparer making  
16 understatements of liability based upon unreasonable positions  
17 on a tax return or claim for tax refund shall pay a penalty of  
18 \$500, with respect to each such tax return or claim for tax

1 refund, unless there is reasonable cause for the understatement  
2 and the tax return preparer acted in good faith. For the  
3 purposes of this section, any position is not unreasonable  
4 unless the position is contrary to or not supported by  
5 substantial authority for the position.

6 (b) A tax return preparer wilfully or recklessly makes an  
7 understatement of liability based upon unreasonable positions on  
8 a tax return or claim for tax refund if the tax return preparer:

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

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

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

16 (c) For purposes of subsections (a) and (b),  
17 understatements of liability using unreasonable positions occur  
18 when:

19 (1) Any part of a tax return or claim for tax refund is  
20 based on a position that does not have substantial  
21 authority;

1       (2) Any tax return preparer who prepares a tax return or  
2       claim for tax refund knew or reasonably should have  
3       known of such an unreasonable position; and

4       (3) The unreasonable position was not a disclosed item as  
5       provided in subsection (h) or was frivolous.

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

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

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

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

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

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

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

8       (f) If there is a final administrative determination or a  
9       final judicial decision that the penalty assessed under  
10       subsection (a) or (b) should not apply, then that portion of the  
11       penalty assessed shall be voided. Any portion of the penalty  
12       that has been paid shall be refunded to the tax return preparer  
13       as an overpayment of tax without regard to any period of  
14       limitations which, but for this subsection, would apply to the  
15       making of the refund.

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

20       (1) Any action under this subsection may be brought in the  
21       circuit court of the circuit in which the tax return  
22       preparer resides or has a principal place of business,

1 or in which the taxpayer with respect to whose tax  
2 return the action is brought resides;

3 (2) The court may exercise its jurisdiction over the  
4 action separate and apart from any other action  
5 brought by the State against the tax return preparer  
6 or taxpayer;

7 (3) If the court finds that a tax return preparer has  
8 engaged in conduct subject to penalty under subsection  
9 (a) or (b) and that injunctive relief is appropriate  
10 to prevent the recurrence of that conduct, the court  
11 may enjoin the preparer accordingly; and

12 (4) If the court finds that a tax return preparer has  
13 continually or repeatedly engaged in conduct  
14 prohibited under subsection (a) or (b) and that an  
15 injunction prohibiting that conduct would not be  
16 sufficient to prevent the preparer's interference with  
17 the proper administration of this chapter, the court  
18 may enjoin the preparer from acting as a tax return  
19 preparer.

20 (h) For purposes of this section:

21 "Disclosed item" means any item where:

1       (1) The relevant facts affecting the item's tax treatment  
2       are adequately disclosed in a tax return or in a  
3       statement attached to a tax return; and

4       (2) There is a reasonable basis for the tax treatment of  
5       the item by the taxpayer.

6       "Substantial authority" means, in addition to any  
7       definition of substantial authority incorporated by subsection  
8       (j), only the following authority for purposes of determining  
9       whether there is substantial authority for the tax treatment of  
10      an item:

11       (1) Statutory provisions;

12       (2) Proposed or final administrative rules;

13       (3) Tax information releases or procedures;

14       (4) Department of taxation announcements or official  
15       explanations;

16       (5) Court cases;

17       (6) Legislative intent reflected in committee reports and  
18       floor statements;

19       (7) Private letter rulings, comfort letters, technical or  
20       advice letters, and written determinations to the  
21       extent such are valid and not overruled by other  
22       authority;

1       (8) Department of taxation press releases;

2       (9) Notices or other official pronouncements of the  
3       department of taxation.

4       "Tax return preparer" means any person who prepares,  
5       employs, or supervises one or more persons who prepare a tax  
6       return or a claim for tax refund. Preparation of a substantial  
7       portion of a tax return or claim for tax refund shall be treated  
8       as if it were the preparation of a tax return or claim for tax  
9       refund.

10       "Understatement of liability" means any understatement of  
11       the net amount payable for any tax imposed or any overstatement  
12       of the net amount creditable or refundable for any tax. Except  
13       as otherwise provided in subsection (f), the determination of  
14       whether there is an understatement of liability shall be made  
15       without regard to any administrative or judicial action  
16       involving the taxpayer.

17       (i) The penalty imposed by this section shall be in  
18       addition to any other penalty provided by law.

19       (j) This section shall be construed in accordance with  
20       regulations and judicial interpretations given to similar  
21       provisions of the Internal Revenue Code."

1 SECTION 3. Chapter 231, Hawaii Revised Statutes, is  
2 amended by adding a new section to be appropriately designated  
3 and to read as follows:

4 "§231-B Promoting abusive tax shelters. (a) A person  
5 promotes an abusive tax shelter by:

6 (1) Organizing or assisting in the organization of, or  
7 participating directly or indirectly in the sale of an  
8 interest in:

9 (A) A partnership or other entity;

10 (B) Any investment plan or arrangement; or

11 (C) Any other plan or arrangement; and

12 (2) In connection with any activity described under  
13 paragraph (1), making, furnishing, or causing another  
14 person to make or furnish a statement with respect to:

15 (A) Whether any deduction or credit is allowed;

16 (B) Whether any income may be excluded; or

17 (C) The securing of any other tax benefit by reason  
18 of holding an interest in the entity or  
19 participating in the plan or arrangement,

20 which the person knows or has reason to know is false  
21 or fraudulent or is a gross valuation overstatement as  
22 to any material matter.



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

11        (c) At the request of the director, a civil action may be  
12 brought to enjoin any person described in subsection (a) from  
13 engaging in any conduct described in subsection (a). Any action  
14 under this section shall be brought in the circuit court of the  
15 circuit where the person in subsection (a) resides or where the  
16 person's principal place of business is located. The court may  
17 exercise its jurisdiction over the action separate and apart  
18 from any other action brought by the State against those persons  
19 described in subsection (a). If the court finds that a person  
20 described in subsection (a) has engaged in any conduct subject  
21 to penalty under subsection (b) and that injunctive relief is

1 appropriate to prevent the recurrence of that conduct, the court  
2 may enjoin the person accordingly.

3 (d) For purposes of this section, "gross valuation  
4 overstatement" means any statement of value for any property or  
5 services if:

6 (1) The value so stated exceeds two hundred per cent of  
7 the amount determined to be the correct valuation; and

8 (2) The value of the property or services is directly  
9 related to the amount of any deduction or credit  
10 allowable to any participant.

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

15 (f) The penalty imposed by this section shall be in  
16 addition to any other penalty provided by law.

17 (g) This section shall be construed in accordance with  
18 regulations and judicial interpretations given to similar  
19 provisions of the Internal Revenue Code."

20 SECTION 4. Chapter 231, Hawaii Revised Statutes, is  
21 amended by adding a new section to be appropriately designated  
22 and to read as follows:

1           "§231-C Erroneous claim for refund or credit. (a) If a  
2 claim for refund or credit with respect to tax is made for an  
3 excessive amount, the person making such claim shall be liable  
4 for a penalty in an amount equal to twenty per cent of the  
5 excessive amount; provided that there shall be no penalty  
6 assessed where the penalty calculation under this section results  
7 in an amount of less than \$400.

8           (b) It shall be a defense to the penalty under this section  
9 that the claim for refund or credit had a reasonable basis. A  
10 person claiming the reasonable basis defense shall have the  
11 burden of proof to demonstrate the reasonableness of the claim.

12           (c) For purposes of this section:

13           "Excessive amount" means the amount by which the amount of  
14 the claim for refund or credit for any taxable year exceeds the  
15 amount of such claim allowable for such taxable year.

16           "Reasonable basis" means a standard of care utilized in tax  
17 reporting that is significantly higher than not frivolous or not  
18 patently improper. A reasonable basis position will be more than  
19 arguable and based on at least one or more authorities of either  
20 state or federal tax administration. A position is considered to  
21 have a reasonable basis if a reasonable and well-informed  
22 analysis by a person knowledgeable in tax law would lead that

H.B. NO. 1155

1 person to conclude that the position has approximately a one-in-  
2 four, or greater, likelihood of being sustained on the merits. A  
3 reasonable basis includes innocent mistakes where the excessive  
4 amount is the result of inadvertence, mathematical error, or  
5 where otherwise defined as innocent by the director pursuant to a  
6 formal pronouncement issued without regard to chapter 91.

7 (d) This section shall be construed in accordance with  
8 regulations and judicial interpretations given to similar  
9 provisions of the Internal Revenue Code."

10 SECTION 5. Chapter 231, Hawaii Revised Statutes, is  
11 amended by adding a new section to be appropriately designated  
12 and to read as follows:

13 "§231-D Substantial understatements or misstatements of  
14 amounts; penalty. (a) There shall be added to the tax an  
15 amount equal to twenty per cent of the portion of any  
16 underpayment that is attributable to any substantial  
17 understatement of any tax. The penalty under this section shall  
18 be in addition to any other penalty assessable by law.

19 (b) Except as provided under subsection (c), there is a  
20 substantial understatement of tax for any taxable year if the  
21 amount of the understatement for the taxable years exceeds the  
22 greater of:

H.B. NO. 1155

1        (1) Ten per cent of the tax required to be shown on the  
2                    return for the taxable year, or

3        (2) \$1,500.

4        (c) In the case of a corporation other than a corporation  
5 taxable under subchapter S of the Internal Revenue Code, there  
6 is a substantial understatement of tax for any taxable year if  
7 the amount of the understatement for the taxable year exceeds  
8 the greater of:

9        (1) Ten per cent of the tax required to be shown on the  
10                    return for the taxable year; or

11        (2) \$30,000.

12        (d) For purposes of this section, "understatement" means  
13 the excess of:

14        (1) The amount of tax required to be shown on the return  
15                    for the taxable year; over

16        (2) The amount of tax imposed that is shown on the return,  
17                    reduced by any rebate as that term is defined by  
18                    section 6211(b)(2) of the Internal Revenue Code.

19        (e) The amount of any understatement shall be reduced by  
20 that portion of the understatement that is attributable to:

21        (1) The tax treatment of any item by the taxpayer if there  
22                    is or was substantial authority for such treatment; or

1       (2) Any item if the relevant facts affecting the item's  
2       tax treatment are adequately disclosed in the return  
3       or in a statement attached to the return and there is  
4       a reasonable basis, as defined under section 231-C,  
5       for the tax treatment by the taxpayer.

6       The reduction in this subsection shall not apply to any item  
7       attributable to a tax shelter as described in section 231-B.

8       (f) This section shall be construed in accordance with  
9       regulations and judicial interpretations given to similar  
10      provisions of the Internal Revenue Code."

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

14       "§231-E Statute of limitations; extension for substantial  
15      omissions. (a) Notwithstanding any other law to the contrary  
16      limiting the time for assessment of any tax, if a taxpayer omits  
17      any amount of:

- 18       (1) Gross income or gross proceeds of sale;  
19       (2) Gross rental or gross rental proceeds;  
20       (3) Price, value, or consideration paid or received for  
21       any property;  
22       (4) Gross receipts;

H.B. NO. 1155

1       (5) Gallonage, tonnage, cigarette count, day, or other  
2           weight or measure applicable to any tax;  
3 properly includible therein that is in excess of twenty-five per  
4 cent of the amount stated in the return, the tax may be assessed  
5 or a proceeding in court with respect to such tax without  
6 assessment may be begun without assessment, at any time within  
7 six years after the return was filed.

8       (b) In determining any amount omitted, there shall not be  
9 taken into account any amount that is stated in the return if  
10 such amount is disclosed in the return or in a statement  
11 attached to the return in a manner adequate to apprise the  
12 department of the nature and amount of such item.

13       (c) This section shall be construed in accordance with  
14 regulations and judicial interpretations given to similar  
15 provisions of the Internal Revenue Code."

16       SECTION 7. Section 231-7, Hawaii Revised Statutes, is  
17 amended to read as follows:

18       "**§231-7 Hearings and subpoenas.** (a) The director of  
19 taxation, and any representative of the director duly authorized  
20 by the director, may conduct any inquiry, investigation, or  
21 hearing, relating to any assessment, or the amount of any tax,  
22 or the collection of any delinquent tax, including any inquiry

1 or investigation into the financial resources of any delinquent  
2 taxpayer or the [~~collectibility~~] collectability of any  
3 delinquent tax.

4 (b) The director or other person conducting [~~such hearing~~]  
5 hearings may administer oaths and take testimony under oath  
6 relating to the matter of inquiry or investigation, and subpoena  
7 witnesses and require the production of books, papers,  
8 documents, and records pertinent to such inquiry.

9 (c) If any person disobeys [~~such process,~~] any process or,  
10 having appeared in obedience thereto, refuses to answer  
11 pertinent questions put to the person by the director or other  
12 person conducting such hearing, or to produce any books, papers,  
13 documents, or records pursuant thereto, the director or other  
14 person conducting such hearing may apply to the circuit court of  
15 the circuit wherein the inquiry or investigation is being  
16 conducted, or to any judge of such court, setting forth such  
17 disobedience to process or refusal to answer, and such court or  
18 judge shall cite such person to appear before such court or  
19 judge to answer such questions or to produce such books, papers,  
20 documents, or records, and upon the person's refusal so to do  
21 commit such person to jail until the person testifies but not  
22 for a longer period than sixty days. Notwithstanding the



1 serving of the term of commitment by any person, the director  
2 may proceed in all respects as if the witness had not previously  
3 been called upon to testify. Witnesses (other than the taxpayer  
4 or the taxpayer's or its officers, directors, agents, and  
5 employees) shall be allowed their fees and mileage as in cases  
6 in the circuit courts, to be paid on vouchers of the department  
7 of taxation, from any moneys available for expenses of the  
8 department.

9 (d) Any subpoena issued under this section that does not  
10 identify the person with respect to whose liability or  
11 investigation the subpoena is issued may be served on any person  
12 only after a court proceeding in which the director or other  
13 person establishes that:

14 (1) The subpoena relates to the investigation of a  
15 particular person or ascertainable group or class of  
16 persons;

17 (2) There is a reasonable basis for believing that such  
18 person or group or class of persons may fail or may  
19 have failed to comply with any provision of title 14;  
20 and

21 (3) The information sought to be obtained from the  
22 examination of records or testimony and the identity

1           of the person or persons with respect to whose  
2           liability the subpoena is issued is not readily  
3           available from other sources.

4           (e) The provisions of this section are in addition to all  
5 other provisions of law, and apply to any tax within the  
6 jurisdiction of the department."

7                           PART II. CRIMINAL TAX ENFORCEMENT

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

11           "§231-F Wilful failure to collect and pay over tax. Any  
12 person required to collect, account for, and pay over any tax  
13 imposed by title 14, who wilfully fails to collect or truthfully  
14 account for and pay over such tax shall, in addition to other  
15 penalties provided by law, be guilty of a class C felony and,  
16 upon conviction, shall be subject to one or any combination of  
17 the following:

- 18           (1) A fine of not more than \$100,000;  
19           (2) Imprisonment of not more than five years; or  
20           (3) Probation;

21 provided that a corporation shall be fined not more than  
22 \$500,000."

1 SECTION 9. Section 231-40, Hawaii Revised Statutes, is  
2 amended to read as follows:

3 "[+]§231-40[+] **Interpretation.** Sections 231-34, 231-35,  
4 [~~and~~] 231-36, and 231-F shall be construed in accordance with  
5 judicial interpretations given to similar provisions of Title 26  
6 of the United States Code; consistent therewith, the term  
7 "wilfully" shall mean a voluntary, intentional violation of a  
8 known legal duty."

9 SECTION 10. Section 231-41, Hawaii Revised Statutes, is  
10 amended to read as follows:

11 "[+]§231-41[+] **Statute of limitation for criminal**  
12 **penalties.** Notwithstanding any laws to the contrary,  
13 prosecutions under sections 231-34, 231-35, [~~and~~] 231-36, and  
14 231-F shall be commenced within seven years after the commission  
15 of the offense."

16 PART III. TAX FRAUD PROCEEDINGS

17 SECTION 11. Chapter 231, Hawaii Revised Statutes, is  
18 amended by adding a new section to be appropriately designated  
19 and to read as follows:

20 "§231-G Signature presumed authentic. The fact that an  
21 individual's name is signed on a return, statement, or other  
22 document shall be prima facie evidence for all purposes that the

H.B. NO. 1155

1 return, statement, or other document was actually signed by the  
2 individual."

3 SECTION 12. Section 235-111, Hawaii Revised Statutes, is  
4 amended by amending subsection (c) to read as follows:

5 "(c) Exceptions; fraudulent return or no return. In the  
6 case of a false or fraudulent return with intent to evade tax or  
7 liability, or of a failure to file return, the tax or liability  
8 may be assessed or levied at any time; provided that the burden  
9 of proof with respect to the issue of falsity or fraud shall be  
10 upon the government [~~provided that in the case of a return~~  
11 ~~claimed to be false or fraudulent with intent to evade tax or~~  
12 ~~liability, the determination as to the claim shall first be made~~  
13 ~~by a judge of the circuit court for or in the circuit within~~  
14 ~~which the taxpayer or employer has the taxpayer's or employer's~~  
15 ~~residence or principal place of business, or if none in the~~  
16 ~~State then in the first circuit, upon petition filed by the~~  
17 ~~department of taxation. The petition and other pleadings and~~  
18 ~~proceedings in the matter shall be governed and conducted in~~  
19 ~~accordance with statutory and other requirements relating to~~  
20 ~~proceedings in equity, including all rights to appeal allowed in~~  
21 ~~the proceedings. No assessment or levy of the tax or liability~~  
22 ~~after the expiration of the three year period shall be made~~

H.B. NO. 1155

1 ~~unless so provided in the final decree entered in the~~  
2 ~~proceedings]."~~

3 SECTION 13. Section 237-40, Hawaii Revised Statutes, is  
4 amended by amending subsection (b) to read as follows:

5 "(b) Exceptions. In the case of a false or fraudulent  
6 return with intent to evade tax, or of a failure to file the  
7 annual return, the tax may be assessed or levied at any time;  
8 provided that the burden of proof with respect to the issue of  
9 falsity or fraud shall be upon the government [~~; however, in the~~  
10 ~~case of a return claimed to be false or fraudulent with intent~~  
11 ~~to evade tax, the determination as to the claim shall first be~~  
12 ~~made by a judge of the circuit court as provided in section 235-~~  
13 ~~111(c) which shall apply to the tax imposed by this chapter]."~~

14 SECTION 14. Section 237D-9, Hawaii Revised Statutes, is  
15 amended by amending subsection (d) to read as follows:

16 "(d) In the case of a false or fraudulent return with  
17 intent to evade tax, or of a failure to file the annual return,  
18 the tax may be assessed or levied at any time; provided that the  
19 burden of proof with respect to the issue of falsity or fraud  
20 shall be upon the government [~~; however, in the case of a return~~  
21 ~~claimed to be false or fraudulent with intent to evade tax, the~~  
22 ~~determination as to the claim shall first be made by a judge of~~

1 ~~the circuit court as provided in section 235-111(e) which shall~~  
2 ~~apply to the tax imposed by this chapter]."~~

3 SECTION 15. Section 243-14, Hawaii Revised Statutes, is  
4 amended by amending subsection (c) to read as follows:

5 "(c) In the case of a false or fraudulent statement with  
6 intent to evade tax or liability, or of a failure to file a  
7 statement, the tax or liability may be assessed or levied at any  
8 time; provided that the burden of proof with respect to the  
9 issue of falsity or fraud shall be upon the government [~~+~~  
10 ~~provided that in the case of a statement claimed to be false or~~  
11 ~~fraudulent with intent to evade tax or liability, the~~  
12 ~~determination as to the claim shall first be made by a judge of~~  
13 ~~the circuit court as provided in section 235-111(e) which shall~~  
14 ~~apply to the tax imposed by this chapter]."~~

15 SECTION 16. Section 251-8, Hawaii Revised Statutes, is  
16 amended by amending subsection (d) to read as follows:

17 "(d) In the case of a false or fraudulent return with  
18 intent to evade the surcharge tax, or of a failure to file the  
19 annual return, the surcharge tax may be assessed or levied at  
20 any time; provided that the burden of proof with respect to the  
21 issue of falsity or fraud shall be upon the government [~~+~~  
22 ~~however, in the case of a return claimed to be false or~~

1 ~~fraudulent with intent to evade the surcharge tax, the~~  
2 ~~determination as to the claim shall first be made by a judge of~~  
3 ~~the circuit court as provided in section 235-111(e) which shall~~  
4 ~~apply to the surcharge tax imposed by this chapter]."~~

5 SECTION 17. Except as provided in section 20, this Act  
6 does not affect returns prepared and transactions promoted,  
7 rights and duties that matured, penalties that were incurred,  
8 and proceedings that were begun, before its effective date.

9 SECTION 18. In codifying the new sections created by  
10 section 2 through 6, section 8, and section 11 of this Act, the  
11 revisor of statutes shall insert appropriate section numbers for  
12 the letters used in designating and referring to the new  
13 sections in this Act.

14 SECTION 19. Statutory material to be repealed is bracketed  
15 and stricken. New statutory material is underscored.

16 SECTION 20. This Act shall take effect upon approval;  
17 provided:

18 (1) Section 2 (relating to penalties for preparing returns  
19 with unreasonable positions), section 4 (relating to  
20 erroneous refund claims), section 5 (relating to  
21 substantial understatements), section 6 (relating to  
22 the statute of limitations on substantial omissions),

1 section 11 (relating to fraud assessments), section 12  
2 (relating to fraud assessments), section 13 (relating  
3 to fraud assessments), section 14 (relating to fraud  
4 assessments), and section 15 (relating to fraud  
5 assessments), shall apply to any return prepared,  
6 refund claim, understatement, omission, or fraud  
7 contained in any return where the statute of  
8 limitations on assessment has not expired; provided  
9 that this Act shall not apply to any return prepared,  
10 refund claim, understatement, omission, or fraud in  
11 any return where an amended return is filed by October  
12 1, 2009, to the extent the amended return cures,  
13 corrects, or eliminates any item constituting an  
14 unreasonable position, erroneous refund claim,  
15 substantial understatement, substantial omission, or  
16 fraud as provided in this Act; and



H.B. NO. 1155

1           (2) Section 3 (relating to promoting abusive tax shelters)  
2           and section 8 (relating to failure to withhold and pay  
3           tax), section 9 (relating to failure to withhold and  
4           pay tax), section 10 (relating to failure to withhold  
5           and pay tax), shall take effect on July 1, 2009.

6  
7           INTRODUCED BY:

Calvin Y. Song  
BY REQUEST

8  
JAN 26 2009

**Report Title:**

Tax Administration; Penalty and Enforcement Conformity

**Description:**

Deters tax fraud and promotes uniformity in the tax system by conforming Hawaii tax law to the Internal Revenue Code for preparer penalties and accuracy-related penalties.

JUSTIFICATION SHEET

DEPARTMENT: Taxation

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

PURPOSE: To conform Hawaii tax law to federal law relating to tax administration and criminal tax enforcement.

MEANS: Add seven new sections to chapter 231, Hawaii Revised Statutes (HRS); and amend sections 231-7, 231-40, 231-41, 235-111(c), 237-40(b), 237D-9(d), 243-14(c), and 251-8(d), HRS.

JUSTIFICATION: The purpose of this legislation is to conform Hawaii tax administration, relating to tax compliance, to the Internal Revenue Code.

A. TAX RETURN PREPARERS

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 \$500 for an undisclosed, unreasonable position, and \$1,000 for willful or reckless disregard of the law. An unreasonable position is one not based upon substantial authority. 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. ABUSIVE TAX SCHEME PROMOTERS

This bill proposes a 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;" with regard to promoting abusive tax shelters.

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.

#### C. ERRONEOUS REFUND CLAIMS

Congress recently amended the Internal Revenue Code to allow for a twenty per cent penalty on any excessive refund claims. In relation to tax incentives provided in Title 14, HRS, providing the Department of

Taxation with the ability to assess a penalty for refund or credit claims, where a taxpayer's claim lacks a reasonable basis, will assist with the administration of Hawaii's taxes by providing a deterrent mechanism, which presently does not exist. This penalty is patterned after IRC section 6676.

D. SUBSTANTIAL UNDERSTATEMENT OR MISSTATEMENTS OF TAX

Under current federal law, a taxpayer is liable for a heightened penalty for any understatements considered substantial. This penalty is equal to twenty per cent of the portion that is attributable to a substantial understatement. An understatement is considered substantial where the difference between the amount shown on the return and the amount that should properly be on the return is greater than ten per cent of the tax required to be shown or \$1,500 for individuals (\$30,000 for corporations). Any understatement is reduced by any amount disclosed on a return or where there is substantial authority for the position. This penalty is drawn from IRC section 6662. This penalty increases as noncompliance increases by a taxpayer.

E. EXTENSION OF STATUTE OF LIMITATION ON ASSESSMENT DUE TO SUBSTANTIAL OMISSIONS

Federal law provides the Internal Revenue Service with the authority to revisit an assessment after the ordinary close of the statute of limitation where a taxpayer has been found to have substantially omitted an item of income. Because Hawaii's tax system is one based upon self-assessment, the government is reliant upon taxpayers to accurately and responsibly report items on their return and to submit a proper return. However, where a taxpayer is found to have omitted a large amount of any item from a return, the government is at a disadvantage

after a return is filed where the ordinary three-year statute of limitations closes. This legislation recognizes the government's position and extends the statute of limitations on assessment to six years from the date the return is filed to ensure accurate taxes are paid by those who substantially omit items. This authority is patterned after IRC section 6501.

#### F. JOHN DOE SUMMONS AUTHORITY

As illegal tax schemes increase in complexity, the government is often unable to identify the beneficiaries of a tax scheme when the scheme or the fruits of the scheme are uncovered. In response, Congress provided the Internal Revenue Service with the authority to subpoena records of unknown persons when unlawful tax activity is detected. Upon making a showing to a court that an ascertainable class is likely to have committed tax violations and that the information is otherwise unavailable, the federal government can obtain documents from third parties. This authority, known as a "John Doe Summons," is another tool to combat aggressive tax schemes. This authority is patterned after IRC 7609(f).

#### G. FAILURE TO COLLECT AND PAY TAX WITHHOLDING TAXES

This bill proposes a conformity provision to IRC section 7202, which provides a felony offense for anyone who willfully fails to collect, truthfully account for, or pay over withholding taxes. Withholding taxes are considered trust fund taxes where the employer is liable to collect an employee's income taxes and pay them over to the government. Title 14, HRS, is presently void of criminal liability for failure to properly collect, truthfully account for, and pay over taxes owed. Failure to pay tax or other similar criminal actions are

presently charged and prosecuted under a theft theory.

#### H. SIGNATURES PRESUMED AUTHENTIC

Almost every form filed with the Department of Taxation must be signed by the taxpayer recognizing the penalties allowed for false or fraudulent statements made in connection with a return. The Department relies in good faith that the signatures are authentic and intended to be signed as proffered. By having a presumption that the signature as it appears on the document is authentic, the Department will be relieved of what has proved to be an unnecessary administrative burden, which requires prosecutors and investigators to either establish that a taxpayer signed the return or attempt to prove such through time consuming proceedings. This bill proposes to conform to IRC section 6064, which creates a presumption that any signature on a return or other document is presumed authentic. This mechanism places the burden of showing that the signature is false or fraudulent on the taxpayer, who is in the best position to establish whether or not the signature on the return is authentic.

#### I. ASSESSMENT AND LEVY UPON FRAUDULENT RETURNS

Certain HRS sections are amended to conform to the federal assessment provision at section 6501, IRC. Conforming to such provisions will allow the Department to assess and levy at any time where taxpayers file a fraudulent return or do not file a return. Currently, section 235-111, HRS, requires a court determination that a taxpayer filed a false or fraudulent return before the Department may assess or levy the associated tax or liability. This requirement is especially burdensome where a taxpayer enters a guilty plea that does not result in a court determination. Moreover,

this legislation conforms to taxpayer safeguards when assessments are made at any time by shifting the burden of proof with regard to the liability associated with the falsity or fraud to the government, conforming to Internal Revenue Code section 7454(a).

Impact on the public: The public is impacted only to the extent that Hawaii tax law now conforms to present federal tax law.

Impact on the department and other agencies: The Department of Taxation civil and criminal enforcement functions, the Department of the Attorney General, and the county prosecuting attorney offices will be equipped with the often-utilized and fundamental tax enforcement tools used by the Internal Revenue Service and other similar state tax agencies.

GENERAL FUND: \$4,200,000 revenue gain in fiscal year 2009-2010; \$5,300,000 million revenue gain in fiscal year 2010-2011; \$6,400,000 million revenue gain in fiscal year 2011-2012.

OTHER FUNDS: None.

PPBS PROGRAM DESIGNATION: TAX 100.

OTHER AFFECTED AGENCIES: Department of the Attorney General; County Prosecuting Attorney Offices.

EFFECTIVE DATE: Upon approval; provided that:  
 (1) Amendments relating to penalties for preparing returns with unreasonable positions; erroneous refund claims; substantial understatements; statute of limitations on substantial omissions; and fraud assessments shall apply to any return prepared, refund claim, understatement, omission, or fraud contained in any return where the statute of limitations on assessment



- has not expired; provided that amendments shall not apply to any return prepared, refund claim, understatement, omission, or fraud in any return where an amended return is filed by October 1, 2009, to the extent the amended return cures, corrects, or eliminates any item constituting an unreasonable position, erroneous refund claim, substantial understatement, substantial omission, or fraud; and
- (2) Amendments relating to promoting abusive tax shelters and failure to withhold and pay tax shall take effect on July 1, 2009.