



**TESTIMONY BY MARION M. HIGA, STATE AUDITOR,  
ON H.B. NO. 382, HD1, RELATING TO THE AUDITOR**

**House Committee on Finance**

**February 24, 2011**

Good afternoon Chair Oshiro and Members of the Committee:

I am Marion Higa, State Auditor, and I am testifying in strong support of House Bill No. 382, HD1. This measure provides explicit authority to the Auditor to inspect all accounts, books, records, files, papers, and documents and all financial affairs of the state Department of Taxation (DoTAX). It also requires me to implement internal policies to protect the confidentiality of private personal information contained in tax returns. In addition, this bill provides penalty provisions applicable to the Auditor or Auditor's agent for disclosure of tax information.

As State Auditor, I have the constitutional and statutory responsibility to conduct post-audits of the transactions, accounts, programs and performance of all departments, offices and agencies of the State and its political subdivisions. The state DoTAX is one of these agencies.

In order to carry out my audit responsibilities, Hawai'i Revised Statutes ("HRS") Section 23-5 provides me with broad authority to examine and inspect all accounts, books, records, files, papers, and documents and all financial affairs of every department. Apparently, however, this authority is not broad enough to enable my review for audit purposes of tax returns and others records on file with the DoTAX. In my testimony before the House Committee on Legislative Management on February 11, 2011, I described our past experience with blocked access to DoTAX records while fulfilling a legislative request to audit the department's contracts.

This bill would amend the Auditor's law to permit my access to DoTAX records for auditing purposes and subjects the Auditor or my agent to the same penalties as DoTAX officials for disclosure of tax information. Unless this measure is passed, the Auditor may be unable to fulfill legislative audit requests of DoTAX, thereby rendering the department unauditable.

The bill also directs the Auditor to implement internal policies to protect tax return information, thus providing safeguards for such information. Although not a part of this bill, I want to point out that other safeguards are already in place. Under the Uniform Information Practices Act, *Hawai'i Revised Statutes* Section 92F-19(b), an agency receiving records from another agency is subject to the "same restrictions on disclosure of the records as the originating agency." Thus, if confidential records are received by the Auditor from DoTAX, the UIPA directs the Auditor to maintain the confidentiality of those records.

In addition, as many of you know, my office adheres to the U.S. Government Accountability Office's *Government Auditing Standards*, which provide a framework for performing high-quality audit work with competence, integrity, objectivity, and independence. By adhering to these standards, we are charged with leading by example in the areas of transparency, performance, accountability and quality through the audit process. These standards, together with the UIPA and this bill's safeguards, should assure this Committee of our commitment to maintaining the confidentiality of taxpayer information.

We respectfully request that you pass this measure out of committee. Thank you for the opportunity to testify in strong support of House Bill No. 382, House Draft 1. I am available for your questions.

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## HOUSE COMMITTEE ON FINANCE

### TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING HB 382, HD 1 RELATING TO THE AUDITOR

**TESTIFIER:** FREDERICK D. PABLO, DIRECTOR OF TAXATION  
(OR DESIGNEE)  
**COMMITTEE:** FIN  
**DATE:** FEBRUARY 24, 2011  
**TIME:** 2:30PM  
**POSITION:** SUPPORT INTENT; CONCERNS

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This measure expressly authorizes the State Auditor to inspect the records of the Department of Taxation. The amendments made by the previous committee addressed many of the Department's concerns related to the protection of confidential taxpayer information.

Therefore, the Department of Taxation (Department) supports the intent of this bill, however continues to have concerns.

**STRONG PUBLIC POLICY FOR PROTECTION OF TAXPAYER INFORMATION**—There is a strong public policy for protecting citizens' confidential information included in tax returns as is obvious by the enactment of §235-116, which makes the disclosure of returns unlawful.

The Department, by law, is required to hold all taxpayer information in the strictest confidence. The amendments made in this HD1 alleviate many of the Department's concerns by subjecting the Auditor to the same confidentiality laws as all other Department personnel.

**NO OBJECTION TO STATE AUDITOR REVIEW IN GENERAL**—The Department does not object to the general premise that the State Auditor have legitimate access to the Department's records.

**ALLOW ACCESS ONLY AFTER POLICIES ARE ADOPTED IN A WRITTEN AGREEMENT WITH THE DEPARTMENT**—The Department suggests that this bill be amended to authorize disclosure only pursuant to written agreements with the Department. There are several issues relating to disclosure that must be negotiated and not left to the discretion of the Auditor, for example:

- All non-tax officials are required to sign an agreement regarding safeguarding the confidentiality of tax returns and return information;
- All documents should be maintained at secured premises only;
- No documents should be allowed to be copied;
- No documents may leave the premises;
- No documents may be electronically transmitted;
- The Department will likely need to consult with its IRS counterparts to ensure that any disclosure to the Auditor does not run afoul of existing IRS disclosure agreements;
- All documents must be returned and destroyed;

Each of these issues arise in any information sharing situation and must be negotiated. Therefore, the Department requests this bill be amended to require a written agreement between the Auditor and the Department, addressing all of the above issues, before the commencement of an audit.

**FINDING AN ACCEPTABLE SOLUTION**—In light of the recent audit by the Auditor, the Department will continue to work with the Committee and the Auditor to find an acceptable solution to the issues that confronted the Auditor during the most recent visit.

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**SUBJECT:** ADMINISTRATION, Audit of the department of taxation

**BILL NUMBER:** HB 382, HD-1

**INTRODUCED BY:** House Committee on Legislative Management

**BRIEF SUMMARY:** Amends HRS section 23-5 to direct the state auditor to inspect all accounts, books, records, files, papers, and documents and all financial affairs of the state department of taxation provided that internal policies to protect the confidentiality of private personal information contained in tax returns shall be implemented.

Amends HRS section 235-116 to provide that the penalty provisions relating to the disclosure of tax return information shall be applicable to the state auditor.

Makes conforming amendments to HRS sections 231-18, 237D-13 and 251-12.

**EFFECTIVE DATE:** Upon approval

**STAFF COMMENTS:** While the current law requires the state auditor to review all state departments, this measure would grant explicit authority to the auditor to conduct a review of the state department of taxation and require the auditor to implement policies to insure the confidentiality of tax return information. While the Auditor and the legislature may believe that it is critical to the examination of the operations of the department of taxation, caution should still be exercise as the confidentiality of information on income tax returns is mandated by the federal government should Hawaii wish to continue income tax information sharing between the federal Internal Revenue Service and the department.

Under section 6103(p)(8) of the Internal Revenue Code which was added by the Tax Reform Act of 1976 (P.L. 94-455), the disclosure of federal tax return information to states requiring the filing or reporting of federal tax information would be prohibited after December 31, 1978 if the state did not adopt legal provisions protecting the confidentiality of the federal tax return information.

Until 1978, HRS Section 235-116, in general, made it unlawful for a state employee to intentionally make a disclosure of a return or return information except as authorized by law. Thus, in 1978, upon the advice of the IRS Regional Counsel Western Region, it is their opinion that HRS Section 325-116 did not meet the standards of Internal Revenue Section 6103(p) (8) because it does not specifically provide that returns are confidential. As a result, HRS 235-116 was amended by Act 172, SLH 1978, to specify that disclosure of income tax information was prohibited except specifically authorized by law. Before adopting the amendments made by this measure, lawmakers should check to see if this measure meets the standard of authorization required by the IRS.

Digested 2/23/11