



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

House Committee on Legislative Management

February 11, 2011

Good afternoon Chair Yamashita and Members of the Committee:

I am Marion Higa, State Auditor, and I am testifying in strong support of House Bill No. 382. 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.

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, Hawaii 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 of tax returns and other records on file with the DoTAX.

Lack of access to DoTAX records undermines my constitutional and statutory audit authority and seriously hindered our work in a recent audit of DoTAX contracts, Report No. 10-11, *Management and Financial Audit of Department of Taxation Contracts*. This audit responded to

Senate Concurrent Resolution No. 78, Senate Draft 1, of the 2010 legislative session. Under the guise of protecting taxpayer information, the former DoTAX director collected, screened, culled, and re-screened all documents requested by our audit team. In fact, documentation usually gathered by our audit team—including public documents such as organization charts, budget documents, position descriptions, and contract files—was put through the same rigorous and time-consuming review. This screening process of public information for a legislatively requested audit was unique and unprecedented and hindered our audit work. As a result, in our report we included a recommendation that the Legislature consider amending the DoTAX statutes to coincide with the Internal Revenue Code to allow state audit agencies authorized under the laws of the State to audit state revenues and programs. This is the genesis of the bill before you today.

This bill would amend the Auditor's law—in particular, Section 23-5, Hawai'i Revised Statutes—to provide for *specific* authority to access DoTAX records for audits or investigations conducted by my office. Moreover, the bill includes safeguards for taxpayer information by requiring that we implement internal policies to protect that information. In addition, the bill would amend Section 231-18, HRS, in the DoTAX's law to recognize the Auditor's authority to inspect DoTAX's records for auditing purposes. Unless these provisions of law are amended, we are, in effect, foreclosed from any audit work in the department.

Accordingly, 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.

NEIL ABERCROMBIE
GOVERNOR

BRIAN SCHATZ
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HOUSE COMMITTEE ON LEGISLATIVE MANAGEMENT

TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING HB 382 RELATING TO THE AUDITOR

TESTIFIER: FREDERICK D. PABLO, INTERIM DIRECTOR OF
 TAXATION (OR DESIGNEE)

COMMITTEE: LGM

DATE: FEBRUARY 11, 2011

TIME: 2PM

POSITION: OPPOSED TO CURRENT DRAFT

This measure expressly authorizes the State Auditor to inspect the records of the Department of Taxation, as well as grants tax return disclosure authority to the auditor.

The Department of Taxation (Department) **opposes this measure as currently drafted** because there are **insufficient statutory safeguards**.

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 passage of this bill would reduce privacy rights.

The Department, by law, is required to hold all taxpayer information in the strictest confidence. The only persons deemed to have interest in taxpayer returns and information is a narrow few that have direct involvement in the administration of Hawaii taxes. The Auditor does not qualify as one having a need to access specific return information that rises to the level of access contemplated by this legislation.

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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. However, this measure does not include sufficient safeguards to permit the Auditor to handle sensitive tax information, specifically the requirement that the Auditor be subject to criminal penalties for unauthorized disclosure of tax information.

THE DEPARTMENT DOESN'T SEE THE NEED FOR THE AUDITOR TO HAVE SPECIFIC RETURN INFORMATION—The Department was recently audited by the Auditor relating to its computer vendor contract. As noted in the report, the Auditor raised the issue of limited access to certain Department premises. To have access, the Auditor must agree to be subject to the same disclosure restrictions and criminal sanctions to which all other tax officials are subject.

This measure; however, appears to give the Auditor unfettered access to specific return data and the returns themselves without any basis. The Department has concerns with allowing access to tax return information because the Auditor's duties do not include tax administration.

ACCESS TO TAX INFORMATION MUST BE SUBJECT TO CRIMINAL PENALTIES, AS IS THE CASE FOR DEPARTMENT PERSONNEL—If the Auditor is to have access to any tax information, the Auditor must be on the same playing field as Department employees. All Department employees are subject to dismissal and criminal penalties for disclosure of tax information. This bill merely allows the Auditor to "implement internal policies" without legislative oversight. The bill must be amended to subject the Auditor to the same criminal deterrent as all other tax officials.

Language could be patterned after HRS § 235-116 and read:

§235-116 Disclosure of returns unlawful; penalty.
All tax returns and return information required to be filed under this chapter shall be confidential, including any copy of any portion of a federal return which may be attached to a state tax return, or any information reflected in the copy of such federal return. It shall be unlawful for any person, or any officer or employee of

the State, including the state auditor or the auditor's agent, to make known intentionally information imparted by any income tax return or estimate made under sections 235-92, 235-94, 235-95, and 235-97 or wilfully to permit any income tax return or estimate so made or copy thereof to be seen or examined by any person other than the taxpayer or the taxpayer's authorized agent, persons duly authorized by the State in connection with their official duties, the Multistate Tax Commission or the authorized representative thereof, except as provided by law, and any offense against the foregoing provisions shall be punished by a fine not exceeding \$500 or by imprisonment not exceeding one year, or both.

Such additions must be added to HRS §§ 235-116, 237-34, 237D-13, and 251-12.

ALLOW ACCESS ONLY AFTER POLICIES ARE ADOPTED AFTER 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 foregoing issues arise in any information sharing situation and must be negotiated. Therefore, this bill must be amended to take into account further negotiation.

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. This measure; however, is not the solution as currently drafted.

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SUBJECT: ADMINISTRATION, Audit of the department of taxation

BILL NUMBER: HB 382

INTRODUCED BY: Say by request

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.

Makes conforming amendments to HRS section 231-18.

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 the tax return information.

Digested 2/10/11