

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: ADMINISTRATION, GENERAL EXCISE, Whistleblower awards, penalty provisions; notification

BILL NUMBER: SB 2238, HD-1

INTRODUCED BY: House Committee on Economic Revitalization and Business

BRIEF SUMMARY: Whistleblower Awards - Adds a new section to HRS chapter 231 to provide that if the director of taxation proceeds with an administrative or judicial action for any violation of HRS Title 14 based on information received from an individual, that individual shall receive an award of at least 15% but not more than 30% of the collected proceeds including penalties, interest, additions to tax, and additional amounts; provided that no award shall be made unless: (1) in the case of actions brought against an individual taxpayer, the taxpayer's gross income exceeds \$200,000 for any taxable year subject to the action; (2) the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed \$500,000; and (3) the information provided to the director of taxation by the individual is submitted under penalty of perjury.

If the director of taxation determines that the proceedings are based on disclosures of specific allegations, rather than information provided by the individual resulting from a judicial or administrative hearing, or from a governmental report, hearing, audit, or investigation, or from the news media, the director of taxation may award such sums as the director of taxation determines to be appropriate, but in no case more than ten percent of the collected proceeds, including penalties, interest, additions to tax and additional amounts, resulting from the action, any related actions, or any settlement in response to the action, taking into account the significance of the individual's information and the role of the individual and any legal representative of the individual in contributing to the action.

If the director of taxation determines that the claim for an award under this section is brought by an individual who planned and initiated the activities that led to the violation, the director may reduce the award accordingly; provided that if the individual is convicted of criminal conduct arising from those activities, the director of taxation shall deny any award. Within 30 days of any determination regarding an award, the determination may be appealed to the tax appeal court, which shall have jurisdiction over the matter. No contract with the department shall be necessary for any individual to receive an award under this section.

Penalty Provisions - Amends HRS sections 231-36.4, 231-36.6 and 231-36.8 to prevent the multiple imposition of the penalty provision of 20% on any underpayment that is imposed under HRS section 231-36 (false and fraudulent statements), HRS section 231-36.4 (willful failure to collect and pay over tax); HRS section 231-36.6 (substantial understatements or misstatements of amounts) or HRS section 231-36.8 (erroneous claim for refund or credit). These sections shall be applicable to tax years beginning after December 31, 2011.

GET-Notification - Amends HRS section 237-9.3 to require the director of taxation to notify a nonprofit organization to comply with general excise tax filing requirements before imposing a denial of any general excise tax benefit and provide that the organization shall have 90 days from the date of the receipt of the notice to comply with the requirements.

Amends HRS section 237-41.5 to provide that provisions relating to amount held in trust under the general excise tax shall not apply to any officer, manager, or other person having control or supervision over amounts of gross proceeds or gross income collected to pay the general excise tax and held in trust or who is charged with the responsibility for the filing of returns or the payment of general excise tax on gross income or gross proceeds collected and held in trust for a nonprofit organization.

EFFECTIVE DATE: July 1, 2112

STAFF COMMENTS: Whistleblower Awards - While the proposed measure establishes monetary awards for individuals (whistleblowers) who provide information regarding violations of tax laws, it should be noted that it is applicable only to the department of taxation. The measure sets thresholds which must be exceeded in order for an award to be made to insure that the award is only for major violations of the tax law as well as limits as to the size of the award. Consideration should be given to extending a similar provision to all other state departments and government agencies to allow each government entity to "police" itself and standardize awards and provisions relating to the payout of such awards. Consideration might also be given to tasking these duties to an impartial agency similar to the Auditor's office.

Penalty Provisions - Act 166, SLH 2009, established penalties of 20% of the: (1) portion of any underpayment for an understatement of a taxpayer's tax liability; and (2) excessive amount of the filing of a claim for refund or credit in the event of an erroneous claim for refund or credit. While it appears that multiple penalties for more than one violation of the underpayment provisions may be imposed under the state laws, federal laws prohibit the imposition of more than one penalty even though they are attributable to more than one violation. Adoption of this provision would allow taxpayers to mitigate their burden of an underpayment penalty similar to the federal treatment of a like infraction.

On the other hand, because the department of taxation does have the discretion to waive excessively high penalties, permitting the stacking of penalties for criminal offenses such as provided under HRS 231-36 (substantial understatement of income) and HRS 231-36.4 (wilful failure to pay and collect) may be an effective deterrent to other taxpayers who may intentionally attempt to avoid paying their tax obligations.

General Excise Tax - As a result of Act 155, SLH 2010, in order to receive general excise tax benefits all nonprofit organizations were required to obtain a general excise tax license. This measure would require the director of taxation to notify a nonprofit organization to comply with general excise tax filing requirements before denying the organization any general excise tax benefit. The measure also provides that organization shall have 90 days from the notification to comply with the requirements.

The measure also clarifies the liability of persons having control of monies held in trust for nonprofit organizations who are also responsible for filing and payment of general excise tax on such monies. If the funds are held in trust for a nonprofit organization, the personal liability provisions do not apply to that person.

Digested 3/30/12

ANDREW V. BEAMAN
ANDREW R. BUNN
ANDREW W. CHAR
ROY E. COLOMBE
RAY K. KAMIKAWA
DANTON S. WONG
ADRIENNE S. YOSHIHARA

BETHANY C.K. ACE
ANNE E. LOPEZ
CHASE T. TAJIMA

CHUN, KERR, DODD, BEAMAN & WONG
A LIMITED LIABILITY LAW PARTNERSHIP
FORT STREET TOWER, TOPA FINANCIAL CENTER
745 FORT STREET, 9TH FLOOR
HONOLULU, HAWAII 96813-3815
TELEPHONE (808) 528-8200
FACSIMILE (808) 536-5869
www.chunkerr.com

SENIOR COUNSEL:
EDWARD Y. C. CHUN
WILLIAM H. DODD

GEORGE L. T. KERR
1933-1998

GREGORY P. CONLAN
1945-1991

**THE SENATE
THE TWENTY-SIXTH LEGISLATURE
Regular Session of 2012**

COMMITTEE ON FINANCE

Chair Oshiro, Vice Chair Lee, Members of the Committee

**Hearing Date: Monday, April 2, 2012
Testimony on SB 2238 SD 1 HD 1
(Relating to Taxation)**

Chair Oshiro, Vice Chair Lee, Members of the Committee:

Thank you for scheduling this bill for hearing which 1) establishes monetary awards for whistleblowers, 2) prohibits penalties for substantial understatements or misstatements and for erroneous claims for refund or credit and 3) would amend Act 155 (SLH 2010), . We urge passage of this HD1 version as it relates particularly to the prohibition of penalties for substantial understatements or misstatements. As for the amendments to Act 155, we believe that the proposed amendments do not go far enough and continue to support outright repeal of Act 155.

Section 3 of the measure that prohibits penalties for wilful failure to collect and pay taxes, substantial understatements or misstatements, and erroneous claims for refund or credit from being added to tax underpayments on which certain other penalties are already imposed.

Many new tax penalties were enacted in 2009 through the passage of Act 166. While these penalties are similar to those imposed under the federal Internal Revenue Code, the federal provisions do not stack onto one another for the same violation. This bill will ameliorate the impact of these penalties by prohibiting the assessment of multiple penalties relating to the same tax error.

Sections 5 and 6 of the measure now mandates that nonprofit organization receive notice before denial of general excise tax benefit and limits liability of persons having control of certain amounts held in trust for nonprofit organizations, which is an amendment to Act 155 (SLH 2010).

Act 155 was introduced by the administration in 2010, passed by the Legislature, and signed into law by Governor Lingle. The Act is too heavy handed in its approach to foster tax compliance, and was passed without much notice to the public.

Act 155 applies to gross income received on or after July 1, 2010. Act 155 upsets decades of settled expectations on how the GET is administered by: (1) providing for the forfeiture of GET exemptions, deductions, income splitting, wholesale rates, and any other such GET benefit just because

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the annual Form G-49 reconciliation is not filed within 12 months of its due date; and (2) imposing personal liability on responsible persons who willfully fail pay over unpaid GET, whether or not the GET was passed on and collected.

Forfeiture of GET benefits

As to the forfeiture of GET benefits, this sanction is out of line with the stated purpose of Act 155, i.e., to obtain information about taxpayers' claims of GET benefits. This forfeiture can occur even if all monthly or other periodic Form G-45 returns are filed, and taxes paid and benefits reported thereon. There are enough penalties on the books to penalize taxpayers for not filing the annual Form G-49, e.g., statute of limitations does not begin to run until the Form G-49 is filed even if all periodic Forms G-45 are filed, and monetary penalties for failure to file the Form G-49 on time.

The forfeiture of GET benefits can even prevent a taxpayer from raising exemptions or deductions in an audit, to counter assessments by the department. A taxpayer already has the burden to prove the department wrong when being assessed additional tax, and should be permitted to raise any defenses available.

Many taxpayers will be caught unawares when their GET benefits are forfeited due to Act 155. For example, a wholesaler can lose the benefit of the .5% wholesale GET rate on its gross income and be subject to the 4% retail rate instead just because it forgets to file the annual Form G-49.

Another example is an exempt school that is required to file the IRS Form 990 but forgets to file the Form G-49. This school is now subject to the GET on all of its tuition income. Since the GET liability will be significant, the school's fiscal situation may be such that the GET cannot be paid. However, Act 155 also provides that unpaid GET will now become the personal liability of officers and directors of the school even if it dissolves.

That the department needed to issue TIR 2010-5 to take back the harshness of Act 155 speaks volumes. However, a TIR is only an administrative pronouncement, not the law, and can be withdrawn at any time.

The department has enough powers at its disposal to enforce the tax laws without Act 155. However, if the Legislature feels that the GET forfeiture provision should remain law, then we respectfully ask that you consider amending the Act as follows:

1. Delay its effective date to provide more time and resources to educate the public about Act 155.
2. In lieu of forfeiture of GET benefits, impose civil penalties of a dollar amount per month capped at a dollar amount. See, e.g. IRC § 6652(c)(per diem penalty up to \$5,000 for failure to file information returns); Act 206 (SLH 2007)(per month penalty of \$1,000 up to \$6,000 for failure to file QHTB annual survey).

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3. Give taxpayers the right to assert any GET benefit when audited to offset any assessments under the GET or income tax.
4. Provide an exemption for small businesses.
5. Provide an exemption for exempt organizations that have registered for exemption from the GET. (Current language in HD1 in this regard is too narrow.)
6. Provide that the statute of limitations on assessments is to run from the periodic Form G-45 periodic return filings, not the annual Form G-49.

Personal Liability for Unpaid GET

This will be another trap for the unwary and one that will impose significant personal liabilities due to the GET being imposed on gross income. The GET, being unlike most other states' sales taxes, applies to virtually all economic activity, it pyramids, and is complex. Repeal of this provision of Act 155 is recommended. However, if the Legislature sees fit to retain this provision, I respectfully ask that you consider amending the Act to provide as follows:

1. Delay the effective date of Act 155 to provide for more time and resources to educate the public about Act 155.
2. Limit personal liability only to the amount of the GET visibly passed on and collected from the taxpayer's customers.
3. Permit the responsible person to challenge any assessments against the taxpayer entity within 30 days of being notified of the personal assessment.
4. Give immunity for volunteer board members of tax-exempt organizations. (Although now provided in HD1, the language in HD1 is too narrow.)
5. Permit the right of contribution among responsible persons, as provided under federal law for employment tax liabilities.
6. Afford prior notice procedures for personal assessments, as provided under federal law.
7. Provide a statute of limitations on personal assessments (remarkably, none provided now!).
8. Conform to IRC § 7491(c) on the burden of production being on the government.

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9. Permit taxpayers to direct that payments be applied first to satisfy GET taxes, then to penalties and interest.
10. On liquidation, limit personal liability to the value of assets distributed to the responsible person being assessed.

Very truly yours,

CHUN, KERR, DODD, BEAMAN & WONG,
a Limited Liability Law Partnership



Ray Kamikawa

PETER L. FRITZ
414 KUWILI STREET, #104
HONOLULU, HAWAII 96817
TELEPHONE: 808.426.0000
E-MAIL: PLFLEGIS@FRITZHQ.COM

**HOUSE OF REPRESENTATIVES
THE TWENTY-SIXTH LEGISLATURE
REGULAR SESSION OF 2012**

COMMITTEE ON FINANCE

**Hearing Date: April 2, 2012
Time: 3:00 PM
Testimony on SB 2238, SD1, HD 1
(Relating to Taxation)**

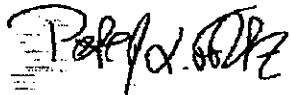
Chair Oshiro, Vice-Chair Lee, and members of the Committee, thank you for the opportunity to testify in support of the intent of Section 2 through 4 of SB 2238, SD1, HD 1.

This purpose Sections 2 through 4 of this bill is to incorporate certain language in Internal Revenue Code ("IRC") that prevents one penalty from stacking on top of another penalty into the analogous provisions in Hawaii law.

While I support the intent of Sections 3 through 5 of this bill, I recommend that the relevant language of HB 1695 SD 1 be inserted into Section 1. The language in HB 1695 SD 1 incorporates comments made by the Department of Taxation.

Thank you for the opportunity to testify.

Respectfully,



Peter L. Fritz