

# TAXBILLSERVICE

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SUBJECT: ADMINISTRATION, Penalty Provisions

BILL NUMBER: SB 2998, SD-1

INTRODUCED BY: Senate Committee on Ways and Means

BRIEF SUMMARY: Amends HRS section 231-36.4 to prevent the multiple imposition of the penalty provision of any underpayment on which a penalty is imposed under HRS section 231-36.8 (erroneous claim for refund or credit).

Amends HRS section 231-36.6 to prevent the multiple imposition of the penalty provision of any underpayment on which a penalty is imposed under HRS section 231-36.8 (erroneous claim for refund or credit).

Amends HRS section 231-36.8 to prevent the multiple imposition of any underpayment on which a penalty is imposed under HRS section 231-36.6 (substantial understatements or misstatements of amounts).

EFFECTIVE DATE: Tax years beginning after December 31, 2011

STAFF COMMENTS: 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.

While the current draft of the measure would limit the imposition of certain multiple penalties, it appears that certain penalty provisions could still be imposed concurrently as compared to the original draft of the measure. While the department of taxation believes that the multiple imposition of penalties is necessary to promote compliance, from the taxpayer point of view, it would mean that compliance is impossible.

Digested 3/13/12

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

**COMMITTEE ON JUDICIARY**

**Chair Keith-Agaran, Vice Chair Rhoads, Members of the Committee:**

**Hearing date: Thursday, March 15, 2012  
Testimony on SB 2998, SD1  
(Relating to Taxation)  
Prohibits Stacking of Penalties**

Chair Keith-Agaran, Vice Chair Rhoads, Members of the Committee:

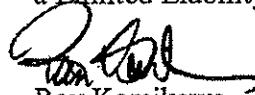
We urge passage of this bill which would prohibit penalties for wilful failure to collect and pay taxes, substantial understatements or misstatements, and erroneous claims for refund or credit from being added to tax underpayments on which certain other penalties are already imposed.

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.

Thank you for affording me the opportunity to testify.

Very truly yours,

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a Limited Liability Law Partnership

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

**COMMITTEE ON JUDICIARY**

**Hearing Date: March 15, 2012**

**Time: 2:00 PM**

**Testimony on S.B. 2998 SD 1  
(Relating to Taxation)**

Chair Keith-Agaran, Vice-Chair Rhoads, and members of the Committee, thank you for the opportunity to testify in support of S.B. 2998 SD1. While I support S.B. 2998 S.D. 1, I prefer the language in H.B. 1695.

This purpose of this bill is to incorporate certain language in Internal Revenue Code (“IRC”) that prevent one penalty from stacking on top of another penalty into the analogous provisions in Hawaii law.

In 2009, several new sections were added to Hawaii Revised Statutes. The two involved in this bill are Hawaii Revised Statute (“HRS”) § 231-36.6 and HRS §231-36.8. HRS § 231-36.6 is an accuracy related penalty and imposes a twenty percent (20%) penalty for substantial understatement or misstatement of tax provisions. It is based on IRC § 6662. HRS § 231-36.8, imposes a twenty percent (20%) penalty for erroneous refund or credit claims. HRS § 231-36.8 is based on IRC § 6676.

Under the current law, the twenty percent (20%) penalty for substantial understatement or misstatement of tax provisions in Hawaii Revised Statute (“HRS”) § 231-36.6 and the twenty percent (20%) penalty for erroneous refund claims in HRS § 231-36.8 could stack resulting in a penalty of forty percent (40%) even though they arose out of the same facts. Such stacking is not permitted under the analogous provisions in the IRC.<sup>1</sup>

An example of such unfairness might occur when an auditor determines that a claim for the Research and Development under HRS § 235.110.91 is erroneous. The auditor disallows the claim and assesses a penalty under HRS § 231-36.8. Because the claim has been disallowed, the taxpayer has underpaid his/her taxes. The auditor then assesses a 20% penalty for a substantial understatement. Under the IRC and Treasury Regulations, only one penalty could be assessed.

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<sup>1</sup> IRS Penalty Handbook Section 5 Related Return Penalties, Section 20.1.5.3.2 paragraph 6 provides “Stacking of IRC 6662, IRC 6663, IRC 6662A, and IRC 6676 penalties is not permitted. The Maximum amount of the IRC 6662 penalty imposed on a portion of the underpayment of the tax is 20 percent . . . of that portion of the underpayment, even if that portion of the underpayment is attributable to more than one type of misconduct under IRC 6662.”

## **IRC § 6662 - Accuracy-Related Penalty - The Foundation for HRS § 231-36.6**

### Historical Background on Penalty:

Prior to 1989, separate sections within the Internal Revenue Code imposed penalties on understatements of tax due to negligence, substantial understatements of tax liability, valuation overstatements for income tax purposes, overstatements of pension liabilities, and valuation understatements for purposes of estate or gift taxes. These individual penalties could be applied cumulatively, so that a single transaction could be subject to multiple penalties.

To improve the coordination of these penalties and to prevent the stacking of these penalties, Congress repealed these separate penalty provisions and combined them into a single accuracy-related penalty under s IRC § 6662(a).

IRC § 6662(a) imposes a 20-percent penalty on the portion of an underpayment of tax attributable to:

- Negligence or intentional disregard of rules or regulations;
- A substantial understatement of income tax;
- A substantial valuation overstatement;
- A substantial overstatement of pension liabilities; or
- A substantial estate or gift tax valuation understatement

The penalty applies only to that portion of the underpayment attributable to the particular underpayment is 20%.

## **IRC § 6676 - Erroneous Claim for Refund or Credit - The Foundation for HRS § 231-36.8**

### Historical Background on Penalty:

Small Business and Work Opportunity Tax Act of 2007 Small Business and Work Opportunity Tax Act of 2007 (the Act) created new penalty risks for both the taxpayer and the preparer with respect to claims for refund, including amended returns claiming a refund.

As background, a taxpayer can be subject to a penalty if the taxpayer's tax return fails to satisfy the standards of care set forth in IRC § 6662 and there was an underpayment of the taxpayer's tax liability.

In general, under the new rule, taxpayers can be subject to a 20% penalty on refund claims if the IRS denies a refund claim and there is no reasonable basis for the claim.

### Details of Penalty:

IRC § 6676 provides a penalty for erroneous refund claims with respect to income taxes.

Under this provision, a penalty equal to 20 percent of the refund that is "excessive" may be imposed if the refund claim is denied and there was no reasonable basis for the portion of the claim that is "excessive" (i.e., the position was merely arguable; less than 15-20 percent likelihood of success). The portion of a refund claim that exceeds the allowable amount of the refund is considered excessive. **The IRC § 6676 penalty does not apply if the IRC § 6662 penalty applies.**

Related Penalties:

**As described above, this penalty would generally apply in cases where the IRC § 6662 penalty may have applied but for the fact that there is no underpayment. Pursuant to IRC § 6676(c), the penalty will not apply to any portion of the excessive amount which is subject to the IRC § 6662 penalty.**

IRC § 6676(c) provides:

(c) Coordination with other penalties.

This section shall not apply to any portion of the excessive amount of a claim for refund or credit which is subject to a penalty imposed under part II of subchapter A of chapter 68.

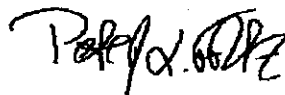
The penalties imposed under Part II of Subchapter A of Chapter 68 are § 6662, § 6662A - Accuracy-Related Penalty on Understatements With Respect to Reportable Transaction; § 6663 - Civil Fraud, and §6664 which provides that no penalty shall be imposed under IRC § 6662 with respect to any portion of an underpayment of tax upon a showing by the taxpayer that there was reasonable cause and the taxpayer acted in good faith.

Why Hawaii's Tax Code Should be Amended

In 2009, the Department testified that "[f]undamentally, this measure is about fairness in the administration [of taxes]. . .". The Department incorporated the provisions of the IRC into Hawaii law and uses regulations for to those provisions to administer the law. However, the anti-stacking provisions were not incorporated into the Hawaii's law. It is not fair to assess (stack) multiple penalties for the same factual situation which is something that is not allowed in the IRC. I respectfully ask this Committee pass this measure and to provide the fairness that the Department claimed was in the original bill. Taxpayers deserve nothing less.

Thank you for the opportunity to testify.

Respectfully,



Peter L. Fritz