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To: The Honorable David Y. Ige, Chair
and Members of the Senate Committee on Ways and Means

Date: Wednesday, April 2, 2014
Time: 9:10 a.m.
Place: Conference Room 211, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. 2370, H.D. 1, Relating to Taxation

Department of Taxation (Department) strongly **opposes** H.B. 2370, H.D. 1, which would apply partial payments of taxes equally to interest, penalties, and principal due to the impact it will have on the Department's limited budget and staffing resources, if adopted.

H.B. 2370, H.D. 1, amends section 231-27, Hawaii Revised Statutes (HRS), to change the hierarchy of partial payments from first to interest, then to penalties, and then to principal, to prorated amounts (in equal amounts). H.D. 1 has a defective effective date of July 1, 2030.

The measure as written will require immediate changes to the Department's procedures and computer system. These computer system modifications would require significant staffing resources to complete the modifications, as modification to the penalties and interest functions of our computer system are considered the most difficult to perform and are considered a "high risk" project by Department staff. As the Legislature is aware, the Department has an outdated computer system with significant functionality issues. The staffing resources necessary to develop and implement this type of modification to the system are not available at this time.

The Department currently is embarking on procuring and developing a new computer system commonly referred to as Tax System Modernization. As a result, the Department's limited resources must be prioritized to address other significant projects that will occur over the next few years, and respectfully request that no new projects be imposed on the Department.

Finally, if at a later date, the Legislature wanted to revisit the allocation of partial payments, rather than follow the allocation proposed in H.B. 2370, H.D. 1, the Department suggests following the federal method of partial payment allocation, where payments are generally allocated to the earliest unpaid and collectible liability, owed and due as of the payment availability date.

For example, the oldest open Collection Statute Expiration Date is applied in the following order: (1) tax; (2) tax motivated transaction (TMT) tax; (3) penalties and fees; (4) non-TMT interest; and (5) TMT interest. The Department generally supports conforming to the federal statutes, but respectfully requests that the Department be first allowed to focus on its Tax System Modernization effort.

Thank you for the opportunity to provide comments.



Chamber of Commerce HAWAII
The Voice of Business

**Testimony to the Senate Committee on Ways and Means
Wednesday, April 2, 2014 at 9:10 A.M.
Conference Room 211, State Capitol**

RE: HOUSE BILL 2370 HD1 RELATING TO TAXATION

Chair Ige, Vice Chair Kidani, and Members of the Committee:

The Chamber of Commerce of Hawaii ("The Chamber") **supports** HB 2370 HD1, which requires that partial payment of taxes be credited in equal amounts to interest, penalties, and principal.

The Chamber is the largest business organization in Hawaii, representing over 1,000 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

The Chamber believes that the amendments provided in HB 2370 is more equitable for both businesses and taxpayers. The bill would alleviate tax burdens to all parties.

Thank you for the opportunity to testify.

TAXBILLSERVICE

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SUBJECT: ADMINISTRATION, Partial payment of taxes

BILL NUMBER: HB 2370, HD-1

INTRODUCED BY: House Committee on Finance

BRIEF SUMMARY: Amends HRS section 231-27 to provide that a partial payment of an assessment of taxes shall be credited to interest, penalties, then principal in equal amounts.

EFFECTIVE DATE: July 1, 2030

STAFF COMMENTS: Currently, when the department of taxation receives a partial payment for an assessment of taxes due, the payment is applied to interest, penalties, then principal. The proposed measure would allow payments to be applied to interest, penalties, and principal in equal amounts. A few years ago when a similar measure was proposed, the department of taxation stated that the adoption of this measure would be contrary to the state's fiscal interest since "state law dictates that tax payments are to be paid first to interest, then penalties, and principal which ensures payment to interest (reflecting time value of money) as the priority, followed by penalties, and then principal. By paying principal last, the State is ensured the optimal time value of money when the principal is paid last and payments are spread over time."

The department has stated in testimony before the House Finance Committee that to implement this legislation, it would require a substantial investment in the department's computer system.

But more importantly, the department in a prior year stated that the adoption of this measure would result in a revenue loss of \$1 million the first year; \$2 million in the second year; and \$3 million in the third year after implementation.

By comparison, for federal purposes Rev. Proc. 2002-26, section 3.02, provides that taxpayers are allowed to designate application of partial payments of tax, and if there is no designation, the payment is applied to tax, penalties and interest, in that order.

Digested 3/31/14