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To: The Honorable Karl Rhoads, Chair
and Members of the House Committee on Judiciary

Date: February 16, 2016

Time: 2:00 P.M.

Place: Conference Room 325, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 2397, Relating to Administrative Tax Appeals and Dispute Resolution Program.

The Department of Taxation (Department) strongly supports H.B. 2397, an Administration measure, and provides the following comments for your consideration.

H.B. 2397, which is effective upon approval, makes several clarifying and technical amendments to section 231-7.5, Hawaii Revised Statutes, relating to the Administrative Appeals and Dispute Resolution Program (AADRP). The Department recently launched the AADRP, which provides taxpayers a streamlined method to quickly and fairly resolve tax disputes over proposed or final assessments. The AADRP, headed by the administrative appeals officer, who works with the compliance division and the taxpayer to settle disputes within a timeframe of 6 to 12 months, thereby providing a quick and cost effective alternative to litigation.

To assist the Department in administering the program, this bill makes several amendments, including: Specifying the deadline for submitting a petition to AADRP; Specifying the procedure for participating in the AADRP when the taxpayer has a case pending with the Board of Review or Tax Appeal Court; and other technical non-substantive amendments. These amendments will clarify procedural requirements and also bring the program into close conformity with appeal programs offered by the Internal Revenue Service.

Thank you for the opportunity to provide comments.



**Testimony to the House Committee on Judiciary
Tuesday, February 16, 2016 at 2:00 P.M.
Conference Room 325, State Capitol**

**RE: HOUSE BILL 2397 RELATING TO ADMINISTRATIVE TAX APPEALS AND
DISPUTE RESOLUTION PROGRAM**

Chair Rhoads, Vice Chair San Buenaventura, and Members of the Committee:

The Chamber of Commerce Hawaii ("The Chamber") **would like to provide comments on HB 2397**, which amends section 231-7.5, Hawaii Revised Statutes, to clarify the types of cases that can be appealed, clarify certain procedures, and make other technical, nonsubstantive changes.

The Chamber is Hawaii's leading statewide business advocacy organization, representing about 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.

We would like to provide some comments, as the current language of this bill is unclear and potentially contradictory.

The bill makes changes to the statute guiding the tax appeals process. Although this function has been authorized by statute for many years, the Department has never implemented it. A working Appeals function would greatly enhance existing procedures for disagreements with the Department of Taxation.

Under the federal system on which the State appeals process is based, to the extent that there is a disagreement between the IRS and a taxpayer, the taxpayer may seek review by an independent "Appeals" office within the IRS. The Appeals office, where appropriate, may offer a compromise to the taxpayer so that the parties can settle their case. This is a good way of resolving disputes as in many cases the issue is not black-or-white and compromise and settlement are appropriate.

The State process was originally intended to mirror the federal process, but as previously noted, the Department of Tax has not yet implemented any program.

Section (b) of the proposed legislation is problematic. It states, in pertinent part, "Decisions of the administrative appeals officer may not be appealed to the board of review or any court."



One reading of this statement is that, once an appeals officer makes a decision, it cannot be reviewed, including by the tax appeal court. The appeals officer could thus decide the case 100% in favor of the State, thereby foreclosing any further judicial review. This may not be the intention of the Department, but the language could be read in this manner.

It is further significant that section (d) directly contradicts section (b), as section (d) states “Nothing in this section shall be interpreted to affect appeal rights provided under section 235-114.” At a minimum, the contradictory provisions should be eliminated.

In general, we do support anything that assists in implementing this program.

Thank you for the opportunity to testify.

TAX FOUNDATION OF HAWAII

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SUBJECT: ADMINISTRATIVE, Tax Appeals and Dispute Resolution Program

BILL NUMBER: SB 2926; HB 2397 (Identical)

INTRODUCED BY: SB by Kouchi by request; HB by Souki by request

EXECUTIVE SUMMARY: Although the proposed amendment is supposed to merely align the appeals officer's duties with those under federal law, the amendment at a minimum muddies the appeals officer's job, and, at worst, creates an option for the taxpayer that would force the taxpayer to waive appeal rights to have a decision on that taxpayer's case made by a Department of Taxation employee who reports to the Director.

BRIEF SUMMARY: Amends HRS section 231-7.5, which is the statute governing the dispute resolution program. Changes the title of the appeals officer to "administrative" from "independent." States that decisions of the administrative appeals officer shall be provided to the taxpayer or return preparer and shall be in writing, and further that they may not be appealed to the board of review or any court. Imposes deadlines for a petition to transfer any case to the dispute resolution program: (1) within twenty days after a notice of proposed assessment; (2) within thirty days after a notice of final assessment; (3) if the taxpayer has appealed to a Board of Review, the taxpayer is required to withdraw the appeal; (4) within thirty days after a notice and demand for payment of a return preparer penalty; (5) if the taxpayer has appealed to Tax Appeal Court, the Director of Taxation and the court must permit the case to go into the program. Provides that nothing in the section shall be interpreted to affect appeal rights otherwise provided.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: This measure was submitted by the Department of Taxation as TAX-06 (16).

The legislature by Act 166, SLH 2009, established an expedited appeals and dispute resolution program of the department of taxation including the designation of an independent appeals officer who is authorized to compromise, settle, and resolve any dispute on an impartial basis.

The measure, as proposed, appears to radically change the appeals officer's job description – from one whose job it is to settle cases to one whose job it is to adjudicate cases. The position was initially established in 2009 and still appears to be vacant, so it is impossible to tell what effect the appeals officer would have. It was established to mirror the appeals office of the IRS, which has been very successful in saving government resources by getting federal tax cases settled rather than litigated. The IRS Appeals Office annually helps over 100,000 taxpayers nationally resolve their tax disputes out of court.

Section 231-7.5, as it presently exists, provides that the administrative appeals officer (note that this is changed from “independent” appeals officer, which may well reflect the Department’s vision of this position) shall be authorized to compromise, settle, or otherwise resolve any dispute. The present measure changes this language to say that the officer “may” be authorized to compromise disputes. If the intent is to allow the department to deprive the appeals officer of settlement authority, this should happen only on an exception basis for special cases (tax shelters, for example).

The proposed measure also provides that taxpayers who have cases in the Board of Review are required to withdraw their cases, which means they give up their right to appeal; underscoring this point is the provision in the bill stating that decisions of the officer are not appealable to the Board or to any court. Although the Department’s justification sheet states that it simply making technical, non-substantive changes to align the duties of the officer more closely with that under federal law, the provisions quoted above appear substantive, and would deepen the divergence that now exists.

At a minimum, it should be recognized that there is an inherent conflict between the settlement process and the adjudication process. A mediator, for example, is often entrusted with information that one party doesn’t want the other side or the adjudicator to know in the hope or expectation that the information will assist in coming to a resolution. Thus, the Hawaii Court Annexed Arbitration Program Rule 11(A)(10) provides that an arbitrator may attempt to aid in settlement of a case only when all parties consent in writing.