



**STATE OF HAWAII
DEPARTMENT OF TAXATION**

830 PUNCHBOWL STREET, ROOM 221

HONOLULU, HAWAII 96813

<http://tax.hawaii.gov/>

Phone: (808) 587-1540 / Fax: (808) 587-1560

Email: Tax.Directors.Office@hawaii.gov

To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Wednesday, February 6, 2019
Time: 2:00 P.M.
Place: Conference Room 308, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: H.B. 115, Relating to Authority of the Department of Taxation to
Correct Errors on Tax Returns

The Department of Taxation (Department) has serious concerns about the impact of H.B. 115 upon overall tax administration, and offers the following comments for the Committee's consideration.

H.B. 115 requires the Department to abate an assessment upon the receipt of a taxpayer's request if the assessment is due to "mathematical or clerical errors." The bill prohibits the Department from levying or proceeding in court for the collection of an assessment due to "mathematical or clerical errors" during a certain period. The bill is effective upon its approval and applies to taxable years beginning after December 31, 2018.

H.B. 115 defines "mathematical or clerical errors" as:

- An error in addition, subtraction, multiplication, or division shown on any return (unless the taxpayer shall have claimed that the applicable rate of tax is lower than the rate of tax applied by the department);
- An incorrect use of any table provided by the department with respect to any return if the incorrect use is apparent from the existence of other information on the return;
- An entry on a return of an item that is inconsistent with another entry of the same or another item on the return;
- An omission of information that is required to be supplied on the return to substantiate an entry on the return;
- An entry on a return of a deduction or credit in an amount that exceeds an applicable statutory limit imposed by the law allowing the deduction or credit; provided that the limit is expressed as:
 - (A) A specified monetary amount; or
 - (B) A percentage, ratio, or fraction; or

- An omission of a correct taxpayer identification number to be included on a return; provided that a taxpayer shall be treated as having omitted a correct taxpayer identification number if the information provided by the taxpayer on the return with respect to the individual whose taxpayer identification number was provided differs from the information the department obtains from the issuer of the taxpayer identification number."

First, Department notes that it already has the authority under section 231-3 of the Hawaii Revised Statute (HRS) to correct any errors on tax returns. Although the bill is named "Relating to the Authority of the Department of Taxation to Correct Errors on Tax Returns," the actual intent of the measure seems to be to provide an automatic abatement when a taxpayer makes a "mathematical or clerical error."

Second, as currently written, the measure would provide an automatic abatement for the additional tax, as well as any applicable penalties and interest. The Department suggests clarifying whether tax may be abated under this new section.

Third, the Department does not believe that the type of abatement proposed by this measure is appropriate or necessary as Hawaii tax law does not contain a penalty for a mathematical error or the resulting underpayment itself. Since there are no penalties based on the mathematical errors or the resulting underpayment itself it not clear which penalty would be abated. For example, if a taxpayer has filed late and the return contains a mathematical error, there is no way to isolate the penalty from the mathematical error.

Fourth, the Department notes that that the definition of "mathematical or clerical errors" is overly broad. Section (d)(1) contains a reasonable component of the definition, but the other parts of the definition seem to significantly exceed the lay meaning of mathematical or clerical error. Additionally, the proposed definition does not consider a taxpayer's intent or repeated errors. As currently written, a taxpayer can make intentional errors and still obtain an automatic abatement simply by requesting an abatement within 30 days. The measure also does not prohibit abatements for taxpayers that continue to make the errors. In other words, taxpayers will be given a consequence free opportunity to pay less than what is owed.

Fifth, each of the penalties that may be assessed under Hawaii tax law already allow for abatement. In most cases, penalties may be abated if the taxpayer has reasonable cause for committing the infraction. For example, the late/failure to file penalty may be abated if the failure is due to reasonable cause and not to neglect.

Sixth, subsection (b) seems to have an internal conflict. This subsection says that a taxpayer's request for abatement must be approved if the taxpayer submits a timely request, but it also goes on to say that the Department must follow the formal assessment procedures if it wants to reassess. It is inconsistent that an abatement would only be approved if it was due to a mathematical error, but the Department would need to go through formal assessment procedures to assess an amount that only became due because of that same mathematical error.

Finally, the Department opposes the amendments made to section 237-36, HRS. When the tax is recalculated based on gross income information provided by the taxpayer, there is no reason that the tax should not become due within 10 days of notifying the taxpayer.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: ADMINISTRATION, DOTAX Authority to Correct Errors on Returns

BILL NUMBER: HB 115

INTRODUCED BY: LUKE, CULLEN

EXECUTIVE SUMMARY: Authorizes the Department of Taxation to correct mathematical and clerical errors on tax returns and assess taxes based on these corrections prior to notifying the taxpayer

SYNOPSIS: Adds a new section to chapter 231, HRS. States that if a taxpayer is notified of an additional amount due because of a mathematical or clerical error, the notice shall not be considered a notice of assessment triggering appeal procedures. Requires the notice to set forth the error alleged and an explanation of it.

Provides that a taxpayer so notified can disagree by requesting an abatement of the additional assessment within 30 days. If the Department receives such a request, it must abate the assessment and initiate normal appeal procedures (issue notice of proposed assessment, etc.) if it wants to reassess.

Defines “mathematical or clerical error” as:

- (1) An error in addition, subtraction, multiplication, or division shown on any return (unless the taxpayer shall have claimed that the applicable rate of tax is lower than the rate of tax applied by the department);
- (2) An incorrect use of any table provided by the department with respect to any return if the incorrect use is apparent from the existence of other information on the return;
- (3) An entry on a return of an item that is inconsistent with another entry of the same or another item on the return;
- (4) An omission of information that is required to be supplied on the return to substantiate an entry on the return;
- (5) An entry on a return of a deduction or credit in an amount that exceeds an applicable statutory limit imposed by the law allowing the deduction or credit; provided that the limit is expressed as:
 - (A) A specified monetary amount; or
 - (B) A percentage, ratio, or fraction; or
- (6) An omission of a correct taxpayer identification number to be included on a return; provided that a taxpayer shall be treated as having omitted a correct taxpayer identification

number if the information provided by the taxpayer on the return with respect to the individual whose taxpayer identification number was provided differs from the information the department obtains from the issuer of the taxpayer identification number.

Makes a conforming amendment to section 237-36, HRS.

EFFECTIVE DATE: Taxable years beginning after December 31, 2018.

STAFF COMMENTS: The National Taxpayer Advocate recently produced a “Purple Book” containing her top 50 recommendations for the IRS. One of them concerned “math error authority,” which brought to mind one of the failings in Hawaii’s tax system.

On the federal side, disputes between the IRS and taxpayers play out through a lengthy process. The IRS proposes an assessment, the taxpayer responds to it, the IRS finalizes the assessment, and the taxpayer gets to challenge it in court. The IRS, however, does get a short-cut through the process if it is only correcting a math or clerical error that the taxpayer has made. The taxpayer is given one notice instead of the two notices given for a regular assessment, and if the taxpayer doesn’t respond there is no court review.

This abbreviated method may be fine for genuine math errors, which are apt to occur in any complicated tax form that isn’t computer generated (and perhaps even some that are). If the taxpayer has admitted to the existence and amount of all income items but just added them up wrongly, for example, the taxpayer can’t have much of a defense. But the relative speed and convenience of math error procedures motivates the agency to use them even for issues that aren’t math errors. “In her reports to Congress,” the National Taxpayer Advocate says, “she has documented circumstances in which the IRS has used math error authority to address discrepancies and mismatches that go beyond simple arithmetic mistakes and have undermined taxpayer rights” – in no fewer than eight annual reports since 2001.

Here in Hawaii, our statutes don’t even give our Department of Taxation math error authority. If the Department has a beef with a taxpayer, it is supposed to send out a proposed notice of assessment and a final notice of assessment, and give the taxpayer 30 days to respond each time. But the Department has come up with a document called a “line item adjustment letter,” where it not only corrects math errors but also disallows credit claims, among other things. “Please call or send correspondence to the Oahu District Office if you have any questions regarding this notice,” it says. “You may file an amended return with supporting documents or contact the Oahu District Office for the appropriate action to take if you do not agree with the adjustment(s).”

First, how is the Department able to use this letter to get around the statutory assessment procedures when it doesn’t even have math error authority? The IRS has math error authority to fix 17 kinds of errors, all of which are spelled out in statute; IRS has been begging Congress to give it open-ended authority to add other errors by regulation, but Congress hasn’t bought into that idea to date – and for good reason, given the Taxpayer Advocate’s repeated complaints. Here in Hawaii, simplified procedures may be appropriate for genuine math errors or other issues that are not reasonably subject to dispute, but isn’t that a decision for the Legislature to make as

opposed to letting the Department go rogue? Second, are there any standards for when it is appropriate to use this type of letter to summarily adjust a taxpayer's account as opposed to going through the assessment and appeal procedures? Or is one of these letters just sent out when someone in the Department feels like it? Third, isn't the letter at least supposed to give an opportunity for the taxpayer to respond before the Department rushes to final judgment and says, "We're done, and if you don't like it file an amended return"? The words "Due Process" come to mind, as in due process required by both the federal and Hawaii constitutions.

This bill is based on IRC section 6213, the section that grants the IRS math error correction authority.

Recently, the IRS used — or thought about using — math error authority to deny business credits summarily. Consider the case of an individual return claiming business credits on Form 3800, but the return has no schedules C, E, or F attached. In Program Manager Technical Advice (PMTA) 2018-14, the IRS put the brakes on, ruling that it is not to use math error authority to summarily deny the general business credit to an individual taxpayer who claims it on a return without schedules C, E, or F. Certainly one would expect a taxpayer with a business to file one of those schedules, but is it a "math error" to claim a business credit without one? "The math error provisions," the IRS said, "permit summary assessments to correct clear errors readily apparent on the face of a return. They do not permit the Service to resolve uncertainties against a taxpayer. . . . Accordingly, issues regarding the taxpayer's eligibility must be resolved through regular examination and deficiency procedures."

Error correction authority on state returns should be similarly circumscribed. That is what this bill tries to accomplish.

Digested 2/4/2019