



**STATE OF HAWAII**  
**DEPARTMENT OF TAXATION**  
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To: The Honorable Donovan M. Dela Cruz, Chair  
and Members of the Senate Committee on Ways and Means

Date: Monday, February 11, 2019  
Time: 10:00 A.M.  
Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director  
Department of Taxation

Re: S.B. 1516, Relating to Taxation

The Department of Taxation (Department) opposes S.B. 1516 and offers the following comments for the Committee's consideration.

S.B. 1516 amends the penalties for failure to file tax return, failure to pay tax due to negligence or intentional disregard, failure to pay tax after filing timely returns, and interest on underpayments or nonpayment of tax set forth in Hawaii Revised Statutes (HRS) section 231-39. A summary of key provisions are as follows:

- Reduces the penalty for failure to file tax return from 5% to 1% of the amount of tax if the failure is within one month; and reduces the maximum penalty from 25% to 21%;
- Adds a provision for any underpayment due to negligence or intentional disregard of rules, that if the taxpayer pays within 30 days of the notice of the underpayment, the penalty is 10% of the underpayment;
- Adds a provision for any failure to pay tax after filing timely returns, if the taxpayer pays within 30 days after the prescribed filing date, the penalty is 10% of the unpaid tax;
- Reduces the interest rates from 2/3 of 1% per month to 1/3 of 1% per month if payment is made within one month of the notice of underpayment or nonpayment of tax;
- States that there shall be no addition to tax if the taxpayer posts bond, with or without sureties, in an amount specified by the Director of Taxation; and
- Effective upon its approval.

First, the Department notes that tax system relies on voluntary compliance. These penalties support voluntary compliance by penalizing noncompliant taxpayer behavior. Leniency on noncompliant behavior erodes the voluntary tax compliance system. One important part of taxpayer fairness is comparing the treatment of compliant taxpayers who pay taxes on time to noncompliant taxpayers who do not.

Second, the Department notes that the amendment to HRS section 231-39(b)(1) will add much complexity to the failure to file penalty from 5% per month to 1% per month of the amount of the tax for the first month. The Department does not believe that such an amendment is appropriate as the penalty is based on the amount that is underpaid as of the prescribed due date of the return. Thus, if the proper amount of tax has been paid on time there would actually be no penalty imposed on the taxpayer.

Third, it is not appropriate for the penalty for an underpayment due to negligence or intentional disregard of rules under HRS section 231-39(b)(2) penalty to be reduced. This penalty is generally imposed when a taxpayer has taken a position on a return that does not have sufficient basis in law. As such, the law provides for a penalty of up to 25% so that the Department can use its discretion in determining the proper amount of penalty that should be assessed on a case-by-case basis. The proposed amendment would basically allow a taxpayer to take a frivolous position not supported by law on a return with a maximum penalty of 10% if paid within a month.

Fourth, HRS section 231-39(b)(3) provides taxpayers with 60 days grace period for failure to pay tax after filing timely returns before the penalty of up to 20% is applied. It is unclear what the amendment to HRS section 231-39(b)(3) is trying to accomplish because it seems to contradict and restrict the 60 day grace period already provided by stating that the penalty is 10% of the unpaid tax if taxpayers pays within 30 days after the prescribed filing date.

Finally, the Department notes that the amendment to HRS section 231-39(b)(4) to reduce the interest on underpayment or nonpayment of tax from 2/3 of 1% to 1/3 of 1% if payment is made within one month will add unnecessary complexity with very little benefit to taxpayers. Currently, at the rate of 2/3 of 1%, the interest on a \$100.00 tax owed is \$0.66 per month. This bill proposes to lower the first month interest to 1/3 of 1%, which would lower the interest on a \$100.00 to \$0.33 only.

Thank you for the opportunity to provide comments.

# TAX FOUNDATION OF HAWAII

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SUBJECT: TAXATION

BILL NUMBER: SB 1516

INTRODUCED BY: KANUHA

EXECUTIVE SUMMARY: Reduces taxpayer penalties for nonpayments and underpayments by setting lower penalty amounts and interest rates for earlier rather than later payments of the penalty amounts and interest rates and avoiding penalties and interest if the taxpayer posts a bond.

SYNOPSIS: Changes the failure to file penalty in section 231-39(b)(1), HRS, from 5% per month late with a maximum of 25%, to 1% per month late with a maximum of 21%.

Changes the negligence penalty in section 231-39(b)(2)(A), HRS, to no more than 10% if the taxpayer pays the tax and penalty within 30 days of the notice of underpayment.

Changes the failure to pay penalty in section 231-39(b)(3), HRS, to no more than 10% if the taxpayer pays the tax and penalty within 30 days of the prescribed filing date.

Changes the interest on underpayment or nonpayment of tax under section 231-39(b)(4), HRS, to 4% (half the regular rate) if payment is made within one month of the notice and demand for payment.

Eliminates all penalties if the taxpayer posts a bond, with or without sureties, in an amount specified by the director.

EFFECTIVE DATE: Upon approval.

STAFF COMMENTS: At present, Hawaii imposes many different penalties on different types of infractions. The penalties also stack, so a person caught not filing a required return often is written up for 70% penalties (25% for failure to file, 25% for negligence, and 20% for substantial understatement) which is huge compared to the 25% maximum penalties allowed under the federal system for a non-fraudulent return.

This bill represents a sharp departure from the existing philosophy; perhaps it should be given a chance to see if it works better than our current system.

Digested 2/6/2019