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JOSH GREEN M.D.  
LT. GOVERNOR



STATE OF HAWAII  
**DEPARTMENT OF TAXATION**  
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ISAAC W. CHOY  
DIRECTOR OF TAXATION

**LATE**

To: The Honorable Karl Rhoads, Chair;  
The Honorable Jarrett Keohokalole, Vice Chair;  
and Members of the Senate Committee on Judiciary

The Honorable Donovan M. Dela Cruz, Chair;  
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair;  
and Members of the Senate Committee on Ways and Means

From: Isaac W. Choy, Director  
Department of Taxation

Date: Tuesday, April 5, 2022

Time: 10:00 A.M.

Place: Via Video Conference, State Capitol

**Re: H.B. 2177, H.D. 2, Relating to State Tax Administration**

The Department of Taxation (Department) provides the following comments on H.B. 2177, H.D. 2, an Administration measure, for the Committee's consideration. This measure makes the following changes to Hawaii tax law in Chapters 231, 232, and 235, Hawaii Revised Statutes (HRS):

- Improves the Department's flexibility in requiring certain taxpayers to file electronically;
- Enhances accountability for paid tax return preparers;
- Modernizes the out-of-date rules and penalties for electronic funds transfer;
- Updates state law to eliminate redundancies and reflect current administrative processes;
- Clarifies the penalty provisions for failure to file informational returns;
- Adds necessary administrative provision to the withholding liability of certain entities for nonresident taxpayers' distributive share of income; and
- Clarifies the interest rate that the State must pay to taxpayers who have paid into the litigated claims fund and are due a refund.

The Department asks that his measure be deferred. Thank you for the opportunity to testify on this measure.

# TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: ADMINISTRATION, INCOME, Mandatory E-Filing and E-Payment; Penalty Enhancement; Nonresident Quarterly Withholding

BILL NUMBER: HB 2177 HD 2

INTRODUCED BY: House Committee on Consumer Protection & Commerce

EXECUTIVE SUMMARY: Expands the department of taxation's authority to require electronic filings. Requires certain tax return preparers to file returns electronically. Repeals the authorization to require electronic funds transfer or electronic filing if the federal government required that person to file or pay electronically. Removes the timeliness requirement from the electronic funds transfer penalty. Removes the authority of the department of taxation to charge for certified copies of tax clearances. Clarifies tax clearances for liquor license holders. Increases the aggregate cap on late filing penalties. Adds an additional penalty category for late filing of certain informational returns where no tax is due. Clarifies the interest calculations for taxes paid pending appeal. Provides that a partnership, estate, or trust is liable for the required withholding from a nonresident taxpayer's distributive share of income. Effective 1/1/2050.

SYNOPSIS: Amends section 231-8.5, HRS, to allow the department to require more classes of taxpayers to file electronically, including GE and TA filers with more than \$2,000 in annual liability (threshold under existing law is \$4,000). Allows the department to determine a penalty by administrative rule for returns where no tax is required to be shown on the return.

Requires tax preparers expecting to prepare more than 10 returns in a calendar year to file all tax returns electronically if an electronic filing option is available, and imposes a \$50 penalty on both the preparer and the taxpayer for failure to file electronically.

Amends section 231-9.9, HRS, to require tax return preparers expecting to prepare more than 10 returns in a calendar year to remit the payment of taxes by electronic funds transfer. Deletes language that now allows the director to grant an exemption to electronic filing and payment requirements for good cause.

Amends section 231-10.8, HRS, to delete the department's authority to charge \$5 for each certified copy of a tax clearance.

Amends section 231-28, HRS, to allow the department to disclose tax information relevant to a prospective liquor licensee's tax compliance to the licensing agency.

Amends section 231-39(b)(1), HRS, to allow the penalty for filing a tax return late, which now is capped at 25% of the tax deficiency, to swell to 75% of the tax deficiency.

Amends section 231-39, HRS, to add a new paragraph imposing a penalty of \$200 per partner, shareholder, or beneficiary for each month that an informational return (such as a partnership return or S corporation return) is not filed on time, up to a maximum of twelve months.

Amends section 232-24, HRS, to provide that where disputed taxes are paid pending appeal in the litigated claims fund and the taxpayer wins at least part of the dispute, the interest rate in IRC section 6621(a) will no longer be used. Instead, the following rates apply: (1) For corporations whose overpayments are \$10,000 or less, 3%; (2) For corporations whose overpayments exceed \$10,000, 1.5%; and (3) For all other taxpayers, 4%.

Amends section 235-64.2, HRS, to require partnerships, estates, and trusts that are withholding tax on behalf of their nonresident owners or beneficiaries to remit tax payments quarterly.

Makes other technical and conforming changes.

EFFECTIVE DATE: January 1, 2050; changes to E-filing effective on July 1, 2022.

STAFF COMMENTS: This is an omnibus Administration bill sponsored by the department of taxation and designated TAX-03 (22). It may look like a purely technical bill to tweak the niceties of tax administration, but there are some blockbusters buried inside.

**Tripled Penalty for Filing a Late Return.** The ceiling on this penalty gets jacked up to 75%, and that is before other penalties are applied. Unlike the comparable federal penalties, Hawaii penalties stack. Under present law, a non-filer can and does get written up for 70% in penalties (25% for late filing, 25% for negligence, 20% for substantial underpayment of tax). This will go up to **120%** (75% for late filing, 25% for negligence, 20% for substantial underpayment of tax).

**Penalty for Failure to File Partnership, S Corporation, or Trust Returns.** This type of penalty can add up very quickly. A partnership with 100 partners, for example, that files a year late could face a bill of 100 partners x 12 months x \$200 = \$240,000. This penalty is like that provided in section 6698 and 6699 of the Internal Revenue Code. The amount is also similar. The current federal penalty is \$210 per recipient per month and is indexed for inflation.

**Interest on Tax Paid Pending Appeal:** We need to remember that this interest is only paid on money that is adjudged to be overpaid. We are concerned that keeping this rate artificially low does not fairly compensate the taxpayer for the loss of its money during the years an appeal is pending and could incentivize the department to take outlandish or unjustifiable positions on appeal. A fairer method would be to pay the taxpayer the actual earnings of the litigated claims fund on the money that is determined to belong to the taxpayer. This was the approach for several years under *Hawaiian Land Co. v. Kamaka*, 56 Haw. 655, 661-62, 547 P.2d 581, 585 (1976).

Digested: 2/26/2022



**Erica S. Kenney**

Senior Tax Counsel, Western States

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April 4, 2022

Senator Donovan M. Dela Cruz, Chair  
Senator Gilbert S.C. Keith-Agaran, Vice Chair  
Senate Committee on Ways and Means  
Hawaii State Legislature

Senator Karl Rhoads, Chair  
Senator Jarrett Keohokalole, Vice Chair  
Senate Committee on Judiciary  
Hawaii State Legislature

**Re: HB 2177 HD 2 - Partnership Withholding for Corporate Partners – Opposed Unless Amended**

Dear Chairs Dela Cruz and Rhoads, Vice Chairs Keith-Agaran and Keohokalole, and Members of the Committees:

On behalf of the Council On State Taxation (COST), I am writing to respectfully oppose the new partnership withholding payment provisions in Section 7 of House Bill 2177 HD 2, which would amend Hawaii Revised Statutes Section 235-64.2 to require quarterly withholding and remittance of a nonresident taxpayer's distributive share of income attributable to the State, including for corporate partners.<sup>1</sup>

Our members do not oppose the intent of this provision; however, many are concerned that this requirement is duplicative, administratively inconsistent, and burdensome since many corporate partners are already subject to separate withholding and estimated payment provisions. COST respectfully requests that this Committee consider amending HB 2177 HD 2 to exclude its application to partners that are subject to separate estimated payment requirements.

**About COST**

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of over 500 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. Many COST members have operations in Hawaii that are impacted by this issue.

To address the burdensome provisions of HB 2177 HD 2 on corporate partners and to ensure fairness and efficiency in Hawaii's partnership withholding regime, we propose an

<sup>1</sup> Note that COST previously submitted this letter to members of the Senate Committee on Ways and Means and the Senate Committee on Judiciary on March 14, 2022 via email. COST now respectfully submits this letter for the April 5, 2022 hearing record.

exclusion from the Section 7 requirements for the portion of withholding related to corporate partners, since those entities have their own estimated payment requirements.

We recommend adding the following new subsection (g) to the end of Section 7 in HB 2177 HD 2, to be included in H.R.S. Section 235-64.2 to allow a waiver from the partnership withholding requirement in such cases:

*(g) The withholding requirement under subsection (a) shall not apply to any nonresident partner, member, shareholder, or beneficiary which has entered into an agreement with the partnership, estate, or trust, in the form and manner prescribed by the department, whereby the nonresident partner, member, shareholder, or beneficiary agrees to comply with the applicable provisions of this chapter.*

For the reasons discussed above, we strongly encourage amending HB 2177 HD 2 to include the proposed exclusion to rectify an otherwise burdensome administrative practice.

Respectfully,



Erica S. Kenney

cc: COST Board of Directors  
Douglas L. Lindholm, COST President & Executive Director



Wealth Management Group

**LATE**

To: Members of the Senate Committees on Judiciary and Ways and Means

From: Johnnel Nakamura  
Vice President & Trust Tax Manager  
First Hawaiian Bank

Date: April 4, 2022

**Re: H.B. 2177, H.D.2, Relating to State Tax Administration**

First Hawaiian Bank has the following comments and concerns regarding House Bill 2177, H.D.2.

**Section 7 of the Bill Regarding Withholding by Partnerships, Estates and Trusts**

The income taxation of trusts, estates, and their beneficiaries is one of the most complex and confusing areas of income taxation. Trusts and estates are not passthrough entities like partnerships. In general, the partners are taxed on the income earned by the partnership and the partnership, itself, pays no tax. In addition, the partners have an ascertainable ownership percentage in the partnership. Although there can be varying ownership percentages even in a partnership.

In contrast, a trust or estate generally pays tax on the income that it does not distribute to the beneficiaries and the beneficiaries pay tax on the income that is distributed to them. In addition, there is no clear percentage ownership or interest of a trust beneficiary in a trust that provides for discretionary distributions. Because the proposed legislation requires withholding based on the beneficiaries' percentage ownership, benefit, or other interest in the estate or trust, the trustee will be unable to determine the amount to be withheld.

Due to these issues and other complexities of trust operation and taxation, the provisions requiring withholding by trusts and estates for nonresident beneficiaries would present significant issues in trust administration and should be deleted from this bill. See attached requested changes to the bill.

**Section 5 of the Bill Regarding Failure to File Informational Returns**

The failure to file informational returns in the new section 5 of 231-39(b) should not apply to section 235-94, which imposes a filing requirement on estates and trusts. The income tax return filed by estates and trusts is not an informational return but is used to calculate the income tax due for the trust or estate. Estates and trusts are not pure passthrough entities for tax purposes but are hybrid entities that incur entity level taxes and should not be treated like partnerships and S Corporations. In addition, since the new provision seems to be aimed at returns involving partners, shareholders, and

beneficiaries, both sections 235-94 and 235-96 should be deleted from the proposed new section 231-39(b)(5).

**Section 5 of the Bill Regarding Significantly Increasing Penalties for Failure to File Returns**

The proposed increased failure to file a tax return penalty in this bill is a significant increase in this penalty and will greatly exceed the federal penalty. The current federal failure to file penalty is a maximum of 25% of the tax due on the return so current Hawaii law mirrors the federal law. Frequently, the failure to file penalty is imposed along with the failure to pay penalty, which has a maximum of 25%. Therefore, under the proposed legislation, the maximum combined penalty would be 100% of the tax due. Even at the current penalty maximum of 25%, a delinquent taxpayer faces a tax bill significantly more than the amount due on the return with interest and the combined failure to file and failure to pay penalties.

**Section 10 Regarding the Effective Date of the Bill**

If the penalty increases are kept in the bill, even at a significantly reduced rate, the effective date for the penalty increases should be for tax returns due after December 31, 2022.



HB2177HD2 Requested Changes

SECTION 5. Section 231-39, Hawaii Revised Statutes, is amended by amending subsection (b) to read as follows:

(b) ....

(5) Informational returns with no tax owed. For persons required to file information returns under sections ~~235-94~~, 235-95, ~~235-96~~, and 235-128, who fail to file by the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that the failure is due to reasonable cause and not due to neglect, there shall be assessed a penalty of \$200 for each month or part of a month (for a maximum of 12 months) the failure continues, multiplied by the total number of persons who were partners, or shareholders, or beneficiaries during any part of the tax year for which the return is due.”

SECTION 7. Section 235-64.2, Hawaii Revised Statutes, is amended to read as follows:

“~~[F] Section 235-64.2[.]~~~~–Withholdings by partnerships, estates, and trusts.~~ (a) Partnerships, ~~estates, and trusts~~ shall withhold an amount equal to the highest marginal tax rate applicable to a nonresident taxpayer multiplied by the amount of the taxpayer’s distributive share of income attributable to the State reflected on the partnership’s, ~~estate’s and trust’s~~ return for the taxable period. All amounts withheld shall be paid to the department ~~[of taxation]~~ in a manner that the department may prescribe. Withholding shall not be required to be submitted by a publicly traded partnership, as defined by section 7704(b) of the Internal Revenue Code, otherwise in compliance with this section. A publicly traded partnership shall file an annual information return reporting the name, address, taxpayer identification number, and other information requested by the department ~~[of taxation]~~ of each unit holder with income sourced to the State.

(b) The amount required to be withheld under subsection (a) shall be calculated and submitted to the department on a calendar quarter basis. Payments shall be due on or before the twentieth day of the month, immediately following the end of the quarter.

(c) All taxes withheld by any partnership, ~~estate or trust~~ under this section shall be held in trust for the State and for the payment of the same to the collector in the manner and at the time required by subsection (b). If any partnership, ~~estate, or trust~~ fails, neglects, or refuses to deduct and withhold from the taxpayer’s distributive share, or to pay over, the amount of tax required, the partnership, ~~estate or trust~~ shall be liable to pay to the State the amount of the tax.

(d) A partnership, ~~estate, or trust~~ may recover from the taxpayer any amount that the partnership, ~~estate, or trust~~ should have withheld but did not withhold from the taxpayer’s



distributive share, if the partnership, ~~estate or trust~~ has been required to pay and has paid the amount to the State out of its own funds pursuant to this section.

(e) Taxes withheld and paid to the department on behalf of nonresident taxpayers under this section shall be deemed estimated tax payments in accordance with section 235-97(g).

(f) For purposes of this section “taxpayer’s distributive share of income” means fifty percent of the partnership, ~~estate or trust~~’s gross income attributable to the State for the quarter multiplied by the percentage of ownership, benefit or other interest that the nonresident taxpayer has in the partnership, ~~estate or trust~~.”

**HB-2177-HD-2**

Submitted on: 4/1/2022 9:39:14 PM

Testimony for JDC on 4/5/2022 10:00:00 AM

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Testify</b>
Gerard Silva	Individual	Oppose	Written Testimony Only

Comments:

Taxes are illegal per the Constitution of America any law that goes against the Constitution is Nual and Void!!

TO: Members of the Committees on Judiciary and  
Ways and Means

FROM: Natalie Iwasa, CPA, CFE  
808-395-3233

HEARING: 10:00 a.m. Tuesday, April 5, 2022

SUBJECT: HB 2177, HD2 State Tax Administration (Numerous Changes)

Aloha Chairs Rhoads and Dela Cruz and Committee Members,

Thank you for allowing the opportunity to provide testimony on HB 2177, HD2 which makes changes to the administration of our state taxes.

#### Electronic Filing of Returns

While there have been improvements in the state's online tax website, it is still difficult for some taxpayers to navigate. The state is also behind in updating some taxpayers' accounts for previously filed returns, and this causes confusion for taxpayers.

In addition, if you are going to mandate e-filing of returns, there should be a mechanism in place for tax preparers to prepare the returns and taxpayers to review and then authorize the filings or to submit them directly. Currently, in order to file Form G-6, a tax preparer and taxpayer must share login information. This is not good policy. Drafts of forms should also be allowed to be saved as work progresses.

Taxpayers should not be assessed penalties for not e-filing certain returns as required, especially when there is no tax liability, until the site is more user friendly and allows for tax preparers to prepare all forms with appropriate separate review and filing authorization from the client. In a few cases over the past couple of years, clients have attempted to e-file returns as required, but were unable to do so. In several cases, the forms were not available on their account or were difficult to find, e.g., extension requests for Form G-49.

#### Penalties:

- Increase from 25% to 75% in Section 5(b)(1) -- **Opposed**.
- Informational returns \$200 per month for each shareholder, partner or beneficiary - **Opposed**



## HAWAII ASSOCIATION OF PUBLIC ACCOUNTANTS

Organized August 7, 1943  
P.O. BOX 61043  
HONOLULU, HAWAII 96839



### Committee on Judiciary and Committee on Ways and Means

Tuesday, April 4, 2022 10:00 a.m.  
Conference Room 211 & Videoconference  
State Capitol

**LATE**

### Re: HB2177, HD2 Relating to State Tax Administration

**Opposition to a) expansion of the department's authority to require electronic filing; b) requirement of certain tax return preparers to file electronically; c) increasing cap on late filing penalties, and d) adding additional penalty category for late filing of certain informational returns where no tax is due**  
**Supports: revisions to tax clearance procedures**

Chair Rhoads, Vice Chair Keohokalole and Members of the Committee on Judiciary,  
and

Chair Dela Cruz, Vice Chair Keith-Agaran, and Members of the Committee on Ways & Means:

The Hawaii Association of Public Accountants (HAPA) is the only statewide public accounting organization with chapters on Oahu, Maui, Big Island, and Kauai. HAPA has approximately 500 members, consisting primarily of small to mid-sized CPA firm owners and employees. Hawaii consumers rely heavily upon our members to provide financial, tax, and consulting services for their businesses and personal affairs.

The income tax system is a voluntary tax system, and making compliance with the tax system overly difficult will cause certain taxpayers to avoid the tax system. The State should accommodate taxpayers who are not computer literate, whether as a result of age or language difficulties, and should also recognize that many taxpayers are very concerned about hacking and identity theft, and prefer to paper file. The IRS can't require individuals to electronically file their income tax returns and must provide paper tax forms supplied by the IRS. The State shouldn't impose electronic filing requirements that exceed Federal requirements.

HAPA opposes the additional requirement for partnerships and S corporations to file electronically if the entity's gross income exceeds \$250,000, or if the taxpayer's federal adjusted gross income, as reported on the taxpayer's Hawaii income tax return, exceeds \$100,000 for the taxable year. This additional requirement is burdensome to individuals or entities that elect out of Federal electronic filing. Many of Hawaii's taxpayers are elderly, set in their ways, and do not have ready access to computers or are not computer literate. The State should accommodate taxpayers who are voluntarily complying with tax filing requirements even though it is not the most efficient for the State to process the

paper-filed returns. (See attached Federal Form 8948 filed by tax preparers when taxpayers choose to elect out of electronic filing.)

HAPA also opposes HRS Section 231-8.5 (3) and (4) increasing the threshold for general excise and transient accommodations electronic filing requirements for taxpayers whose total tax liability exceeds \$4,000, as opposed to \$2,000. There are many elderly taxpayers who do not have computers and still prefer to manually file their returns.

HAPA strongly opposes HRS Section 231-8.5 (d) imposing \$50 for every failure of a tax preparer to electronically file a return and failure to remit an electronic payment. Taxpayers are currently allowed to "opt-out" of Federal tax filing, and tax preparers oftentimes are limited to filing the related State returns electronically because the Federal return must be filed electronically in order for the State returns to be filed electronically. Sometimes taxpayers elect out of filing electronically because they are working with IRS representatives, and requests are made to file the returns by paper directly to the IRS representatives. Most often, taxpayers have experienced identity theft or are afraid of identity theft and having their tax information compromised electronically.

Taxpayers currently are also overburdened with responding to penalty assessments that are incorrectly computed or there was reasonable cause to abate the penalty. Too much time is being spent by both tax preparers and the State on responding to notices or asserting reasonable cause explanations.

HAPA also opposes the proposed increase for the failure to file penalties, which it believes are excessive. HAPA believes that the penalty for failure to file information returns with no tax owed is excessive because many Forms 1099 are inadvertently not filed because taxpayers are not aware of their filing obligations or the payee refuses to provide taxpayer information and address when the filing deadline approaches.

Regarding withholding provisions under proposed Section 635-64.2, withholdings should be required on distributions of Hawaii income to nonresident partners/beneficiaries, similar to California and other states. It should not be based on the partnership, estate, or trust's gross income.

HAPA supports the provisions of Section 231-28 regarding changes relating to tax clearance procedures.

Thank you for considering the above. If you have questions, please do not hesitate to contact me at [niwao@mauicpa.com](mailto:niwao@mauicpa.com)

Respectfully submitted,



Marilyn M. Niwao, M.S.P.H., J.D., CPA, CGMA  
Legislative Committee Co-Chair and State Director

## Preparer Explanation for Not Filing Electronically

OMB No. 1545-2200

▶ Go to [www.irs.gov/Form8948](http://www.irs.gov/Form8948) for instructions and the latest information.

Attachment  
 Sequence No. **173**

Name(s) on tax return	Tax year of return	Taxpayer's identifying number
Preparer's name		Preparer Tax Identification Number (PTIN)

**Three out of four taxpayers now use IRS e-file. Go to [www.irs.gov/efile](http://www.irs.gov/efile) for details on using IRS e-file. The benefits of electronic filing include the following.**

- Faster refunds
- Secure transmissions
- E-payment options
- More accurate returns
- Easier filing method
- Receipt acknowledged

Check the applicable box to indicate the reason this return is not being filed electronically. Do not check more than one box.

- 1  Taxpayer chose to file this return on paper.
  
- 2  The preparer received a waiver from the requirement to electronically file the tax return.  
 Waiver Reference Number \_\_\_\_\_ Approval Letter Date \_\_\_\_\_
  
- 3  The preparer is a member of a recognized religious group that is conscientiously opposed to filing electronically.
  
- 4  This return was rejected by IRS e-file and the reject condition could not be resolved.  
 Reject code: \_\_\_\_\_ Number of attempts to resolve reject: \_\_\_\_\_
  
- 5  The preparer's e-file software package does not support Form \_\_\_\_\_ or Schedule \_\_\_\_\_ attached to this return.
  
- 6 Check the box that applies and provide additional information if requested.
  - a  The preparer is ineligible to file electronically because IRS e-file does not accept foreign preparers without social security numbers who live and work abroad.
  - b  The preparer is ineligible to participate in IRS e-file.
  - c  Other: Describe below the circumstances that prevented the preparer from filing this return electronically.

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## HAWAII ASSOCIATION OF PUBLIC ACCOUNTANTS

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### Committee on Judiciary and Committee on Ways and Means

Tuesday, April 5, 2022 10:00 a.m.  
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### Re: HB2177, HD2 Relating to State Tax Administration

Chair Rhoads, Vice Chair Keohokalole and Members of the Committee on Judiciary,  
and

Chair Dela Cruz, Vice Chair Keith-Agaran, and Members of the Committee on Ways &  
Means:

The Hawaii Association of Public Accountants (HAPA) is the only statewide public accounting organization with chapters on Oahu, Maui, Big Island, and Kauai. HAPA has approximately 500 members, consisting primarily of small to mid-sized CPA firm owners and employees. Hawaii consumers rely heavily upon our members to provide financial, tax, and consulting services for their businesses and personal affairs.

HAPA is strongly against any proposals relating to increasing the burden of electronic filing for both taxpayers and tax practitioners. HAPA also strongly opposes any increases to the tax filing penalties.

Thank you for your consideration of the above matter.

Respectfully submitted,

Eric H. Matsuda, CPA  
HAPA State President