

DAVID Y. IGE  
GOVERNOR

JOSH GREEN M.D.  
LT. GOVERNOR



ISAAC W. CHOY  
DIRECTOR OF TAXATION

STATE OF HAWAII  
**DEPARTMENT OF TAXATION**  
P.O. BOX 259  
HONOLULU, HAWAII 96809  
PHONE NO: (808) 587-1540  
FAX NO: (808) 587-1560

To: 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

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

From: Isaac W. Choy, Director  
Department of Taxation

Date: March 3, 2021

Time: 10:35 A.M.

Place: Via Video Conference, State Capitol

**Re: S.B. 1198, S.D. 1, Relating to Tax Administration**

The Department of Taxation (Department) strongly supports S.B. 1198, S.D. 1, an Administration measure. S.B. 1198, S.D. 1, makes the following amendments to Hawaii Revised Statutes (HRS) chapters 231 and 232 to improve general tax administration:

1. Authorizes the Department to require electronic filing for certain partnership, S corporations, and individuals. S.B. 1198, S.D. 1, authorizes the Department to require:
  - Partnerships and S-corporations to file electronically if their gross income exceeds \$250,000 for the taxable year; and
  - Individuals to file electronically if their federal adjusted gross income, as reported on their Hawaii income tax return, exceeds \$100,000 for the taxable year.

The Department notes that electronic filing improves accuracy and efficiency. The Department believes the bill will only affect taxpayers with the ability and sophistication to easily comply with the electronic filing requirement. In addition, these taxpayers are likely already required to file general excise tax returns electronically.

2. Amends the penalty for failure to file electronically to allow the Department, by administrative rule, to determine the penalty if there is no tax shown on the improperly filed return or document.

This provision will allow the Department some flexibility to determine the penalty in

situations where there is no tax liability shown on the return. Currently, the penalty is a percentage of the tax required to be shown on the return. Thus, if no tax must be reported, no penalty can be imposed. It is important to note that the reasonable cause exception to the penalty is still available when applicable.

3. Requires tax return preparers to file electronically if the preparer prepares more than ten returns of the same tax type in the calendar year and imposes a penalty for failure to do so.

This provision will help increase electronic filing and improve accuracy and efficiency. The penalty on tax return preparers for failing to file electronically is \$50 per failure and includes an exception to the penalty for reasonable cause. This electronic filing requirement for return preparers matches the requirements imposed by the Internal Revenue Service.

4. Streamlines the rules for filing and payment of taxes by electronic funds transfer.

The Department has been granted separate statutory authority (HRS section 231-8.5) to require electronic filing since the enactment of HRS section 231-9.9. Therefore, the language authorizing mandatory electronic filing in HRS section 231-9.9 is redundant.

Under current law taxpayers are penalized under HRS section 231-9.9 for failure to pay by EFT and for paying late. Because HRS title 14 contains other penalties for late payment, this measure amends the EFT penalty so that it is only imposed when payment is not made by EFT when required to do so.

In regard to EFT, S.B. 1198 also clarifies the information that the Department reports to the Legislature each year on electronic fund transfer penalties and assessments.

5. Repeals the fee of \$5 for a certified copy of a tax clearance.

The Department no longer offers certified copies of tax clearances so the statute authorizing the Department to charge for them is no longer necessary.

6. Authorizes the Department to make limited disclosures of liquor licensees' tax compliance information directly to the license issuing agency.

The statute that requires a tax clearance to be issued prior to issuing a liquor license must be updated to reflect current administrative processes. This authorization will leverage functionality in our new tax system to streamline the tax clearance process, which benefits both taxpayers and government.

Alternately, because a number of other government agencies require a tax clearance for various purposes, a separate section could be added to enable the Department to provide this information directly to partner agencies.

7. Clarifies the interest rate the State must pay on amounts paid pending appeal that are subsequently determined to be owed to the taxpayer.

Under current law, the interest rate was calculated by reference to Internal Revenue Code (IRC) section 6621(a) as of January 1, 2010. This reference and the date of January 1, 2010 has led to confusion as to how the rate is calculated. This bill repeals the reference to the IRC and defines the interest rate as a fixed rate, consistent with the IRC. The fixed rate proposed is the rate that would be calculated under the Department's interpretation of current law, thus, there is no substantive change in the interest rate.

Finally, the Department respectfully requests that the following amendment to HRS section 235-20.5 be inserted into this bill which was inadvertently omitted from the Department's legislative proposals. This amendment corresponds to Department's budget submitted as part of the Governor's Executive Budget.

- §235-20.5 Tax administration special fund;**  
**established.** (a) There is established a tax administration special fund, into which shall be deposited:
- (1) Fees collected under sections 235-20 and 235-110.9;
  - (2) Revenues collected by the special enforcement section pursuant to section 231-85; provided that in each fiscal year, of the total revenues collected by the special enforcement section, all revenues in excess of [~~\$2,000,000~~] \$5,500,000 shall be deposited into the general fund; and
  - (3) Fines assessed pursuant to section 237D-4.
- (b) The moneys in the fund shall be used for the following purposes:
- (1) Issuing comfort letters, letter rulings, written opinions, and other guidance to taxpayers;
  - (2) Issuing certificates under [~~+~~]section[~~+~~] 235-110.9;
  - (3) Administering the operations of the special enforcement section;
  - (4) Funding support staff positions in the special enforcement section; [~~and~~]
  - (5) Developing, implementing, and providing taxpayer education programs, including tax publications[~~-~~];
  - (6) Funding information technology and related positions that are exempt from chapter 76;
  - (7) Funding the operations of the criminal investigation section, including support staff positions; and
  - (8) Funding the operations of the administrative rules office.

Thank you for the opportunity to provide testimony in strong support of this measure.

DAVID Y. IGE  
GOVERNOR



CRAIG K. HIRAI  
DIRECTOR

ROBERT YU  
DEPUTY DIRECTOR

EMPLOYEES' RETIREMENT SYSTEM  
HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND  
OFFICE OF THE PUBLIC DEFENDER

**STATE OF HAWAII**  
**DEPARTMENT OF BUDGET AND FINANCE**  
P.O. BOX 150  
HONOLULU, HAWAII 96810-0150

ADMINISTRATIVE AND RESEARCH OFFICE  
BUDGET, PROGRAM PLANNING AND  
MANAGEMENT DIVISION  
FINANCIAL ADMINISTRATION DIVISION  
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

**WRITTEN ONLY**  
TESTIMONY BY CRAIG K. HIRAI  
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE  
TO THE SENATE COMMITTEES ON WAYS AND MEANS AND JUDICIARY  
ON  
SENATE BILL NO. 1198, S.D. 1

**March 3, 2021**  
**10:35 a.m.**  
**Room 211**

RELATING TO TAX ADMINISTRATION

The Department of Budget and Finance (B&F) supports the Department of Taxation's (TAX) proposed amendments to Senate Bill (S.B.) No. 1198, S.D. 1.

S.B. No. 1198, S.D. 1, is an Administration bill (TAX-4(21)) that amends Chapters 231 and 232, HRS, to: authorize TAX to mandate electronic filing for certain partnership, S corporation and individual returns; require certain tax return preparers to file returns electronically; amend the rules for electronic funds transfer to remove the authorization to require electronic funds transfer or electronic filing if the federal government required that person to file or pay electronically and require electronic funds transfers for tax return preparers and any person subject to mandatory electronic filing; remove the timeliness requirement from the electronic funds transfer penalty; remove the authority of the department to charge for certified copies of tax clearances; authorize the department to make limited disclosures of liquor licensees' tax compliance information directly to the license issuing agency; and clarify the interest rate for payments made to taxpayers out of the litigated claims fund.

B&F supports the proposed TAX amendments to S.B. No. 1198, S.D. 1, to Section 235-20.5, HRS, which would expand the use of the Tax Administration Special Fund to effectuate the conversion of 7.00 positions from general funds to special funds as proposed in the FB 2021-23 Executive Budget.

Thank you for your consideration of our comments.

# TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: ADMINISTRATION, E-filing requirements and penalty, Clearances

BILL NUMBER: SB 1198, SD1

INTRODUCED BY: Senate Committee on Commerce and Consumer Protection

EXECUTIVE SUMMARY: Allows the Department of Taxation to mandate the electronic filing of partnership and S-corporation returns if the taxpayer's gross receipts exceed \$250,000 and individual tax returns if the federal adjusted gross income as shown on the taxpayer's Hawaii return exceeds \$100,000. Requires certain tax return preparers to file returns electronically. Amends the rules for electronic funds transfer to remove the authorization to require electronic funds transfer or electronic filing if the federal government required that person to file or pay electronically and requires electronic funds transfers for tax return preparers and any person subject to mandatory electronic filing. Removes the timeliness requirement from the electronic funds transfer penalty. Removes the authority of the department to charge for certified copies of tax clearances. Amends the statute that mandates tax clearances for liquor license holders. Clarifies the interest rate for payments made to taxpayers out of the litigated claims fund.

SYNOPSIS: Amends section 231-8.5, HRS, to allow the Department to also require electronic filing of: (1) partnerships whose gross income exceeds \$250,000, (2) S corporations whose gross income exceeds \$250,000, and (3) individuals whose federal AGI exceeds \$100,000. Requires all tax preparers to file electronically for any returns for which the Department provides an electronic filing option and if the preparer reasonably expects to prepare more than 10 returns of that same tax type in a calendar year. Provides for penalties of \$50 each against the preparer and client for noncompliance.

Also provides that the Department by rule may provide for a penalty for failure to e-file even if the tax required to be shown on the return is zero.

Amends section 231-9.9, HRS, to allow the Department to require electronic remittance when the return is prepared by a tax preparer and is required to be e-filed under section 231-8.5 as amended. The 2% penalty is amended to apply only to failure to remit electronically because the penalty for failure to e-file is separate. Deletes the requirement that the Department report to the legislature each of the penalties assessed, but just requires the total.

Amends section 231-10.8, HRS, to delete the Department's authority to charge \$5 for certified copies of tax clearances.

Makes technical amendments to section 231-28, HRS, relating to the tax clearance requirement for liquor licensees.

Amends section 232-24, HRS, to provide that taxes paid pending appeal bear interest at:

- (1) For corporations, 3 per cent;

- (2) For corporations whose overpayments exceed \$10,000, 1.5 per cent; and
- (3) For all other taxpayers, 4 per cent.

EFFECTIVE DATE: Upon approval.

STAFF COMMENTS: This is an Administration bill sponsored by the Department of Taxation and identified as TAX-04 (21).

The amendments do seem to be consistent with the national trend toward e-filing and e-payment, and add clarity to tax administration.

The Foundation notes that under section 231-8.5(c)(2), the Department normally must provide the general public 90 days' written notice of its intention to require mandatory e-filing. However, no notice at all is required before e-filing requirements and the associated penalties are applied to tax preparers, which seems unfair. We suggest changing proposed subsection 231-8.5(d) slightly, to the following:

(d) Notwithstanding subsections (b) ~~and (c)~~, any return that is prepared by a tax return preparer, as defined in section 231-36.5, shall be filed electronically; provided that this subsection shall only apply if the tax return preparer reasonably expects to prepare more than ten returns of that same tax type in the calendar year.

We also suggest that if the legislature wishes to impose a penalty for failing to e-file when no tax is due on the return (proposed section 231-8.5(f)), that it either specify the amount or specify standards to guide DOTAX in setting the penalty, rather than leaving DOTAX with unbridled discretion to set the penalty by administrative rule.

Digested 3/1/2021