

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 Sylvia Luke, Chair;
The Honorable Kyle T. Yamashita, Vice Chair;
and Members of the House Committee on Finance

From: Isaac W. Choy, Director
Department of Taxation

Date: Wednesday, April 6, 2022
Time: 2:45 P.M.
Place: Via Video Conference, State Capitol

Re: S.B. 2377, S.D. 1, H.D. 1, Relating to State Tax Examinations

The Department of Taxation (Department) supports S.B. 2377, S.D. 1, H.D. 1, and offers the following comments for the committee's consideration.

S.B. 2377, S.D. 1, H.D. 1, adds a new provision to chapter 231, Hawaii Revised Statutes (HRS), creating a new penalty for failure to respond or reply to the Department's correspondence or inquiry within a timely manner during an official inspection or examination of records. The penalty is either equal to 25 per cent of tax owed, or not more than \$10,000; the Director of Taxation is authorized to waive the penalty if the failure was due to reasonable cause. The measure takes effect upon approval.

The Department notes that the Committee on Ways and Means amended the bill to provide a savings clause. The Department appreciates this amendment and requests that it remain intact. The previous committee made technical non-substantive changes for clarity, consistency, and style.

The Department appreciates every effort to empower it with the tools and resources to help promote taxpayer compliance and efficient tax administration. The Department is in strong support of this bill and is able to implement the measure as drafted.

Thank you for the opportunity to testify.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: ADMINISTRATION, Establish Civil Penalty for Failure to Respond

BILL NUMBER: SB 2377 HD 1

INTRODUCED BY: House Committee on Economic Development

EXECUTIVE SUMMARY: Establishes a penalty for failure to respond to an inquiry or request during a state tax examination.

SYNOPSIS: Any person who fails to respond or reply to the department's correspondence or inquiry within a timely manner during an inspection or examination of records under paragraph (6) of section 231-3 shall be subject to a penalty equal to twenty-five per cent of the tax owed; provided that the penalty shall not exceed \$10,000. The director may waive the penalty if the failure was due to reasonable cause.

We are greatly concerned that the standards for imposing the penalty generally do not exist in this bill and that the penalty could quickly spiral out of control during the course of an examination. We also do not see the need for this bill given the powers the Department already has.

EFFECTIVE DATE: Upon Approval

STAFF COMMENTS: During the course of a return examination, auditors typically will ask the taxpayer for several rounds of information and documents. Sometimes the taxpayer is able to provide the information and documents; sometimes the documents don't exist or can't be located; sometimes documents can be located and are produced but are not what the auditor is looking for.

Under current law auditors who do not get the information they need as quickly as they need are able to assess the taxpayer based on "best available information." See, for example, section 237-38, HRS. This type of assessment is sometimes based on arbitrary assumptions, such as "150% of the prior year's income," and the onus is then placed on the taxpayer to prove what the taxpayer can.

In our view, failing to cooperate with the tax authorities carries hefty consequences even without an additional penalty.

In addition, the language used in this bill is extremely vague. For example:

- There are no standards in the statute governing what is a reasonable request for records. If the auditor makes a request for records and wants the taxpayer to produce them in a week:

- Does it matter if the taxpayer has to produce 50 or 50,000 pages? Obviously the auditor will have no direct knowledge of what taxpayer records are responsive to the request.
- Is it sufficient if the taxpayer responds to the Department's inquiry with a short letter or email saying that the records are available but will be produced at a later time?
- Is it sufficient to reply to the request by truthfully stating that the taxpayer either does not possess the requested records, or that the records are in control of a third party? Is it fair to require the taxpayer to get those records from the third party under pain of this penalty, or in such cases is it fair to ask the Department to use its subpoena power under section 231-7(c), HRS, to ask the third party to produce the records?
- There are no standards in the statute on what is "a timely manner."
- There are no standards on what is the Department's "correspondence or inquiry."
 - Could it be an oral request during a phone call?
- There are no standards on whether the penalty can be imposed multiple times within the same examination.
 - If the taxpayer is five days late, is the penalty 125%?
 - If the auditor makes ten document requests and the taxpayer produces documents that are, in the auditor's mind, sufficient only as to four of those requests, is the penalty 150% (25% x 6 requests not properly responded to)?

Digested: 4/4/2022

SB-2377-HD-1

Submitted on: 4/4/2022 1:02:28 PM

Testimony for FIN on 4/6/2022 2:45:00 PM

Submitted By	Organization	Testifier Position	Testify
Ron Heller	Individual	Oppose	Written Testimony Only

Comments:

HB2377 proposes a tax penalty on a person who fails to “respond or reply” during a tax audit. There is no definition of what constitutes “failure to respond or reply” – for example, is a taxpayer subject to the penalty if the taxpayer says “I will look for the specific document you want” and then says “I can’t find it”?

There is no exception for cases where the taxpayer is unable to respond – sometimes a taxpayer simply does not have the information the Department wants. There is no exception for information that is privileged, or for an unreasonably broad and overly burdensome request by the Department.

A typical case might involve an audit **in 2022**, of the taxpayer’s return **for tax year 2019**. Sometimes, the taxpayer may have a new CP doing their current tax return, or a new bookkeeper working for their company. The person who assembled the information for the 2019 return may not be around in 2022. Of course, many taxpayers have records that are less than perfect. The reality is that a taxpayer cannot always answer the Department’s questions.

A penalty in these situations is unnecessary. The Department of Taxation already has the power to make a tax assessment that is presumed to be correct. The taxpayer has the burden of proof in any challenge to the Department’s assessment. **Thus, as a practical matter, the penalty for failing to produce evidence and documentation is that issues are resolved against the taxpayer.**

SB 2377 has the additional problem that the penalty can be imposed for failure to produce information in a “timely” manner, but there is no definition of what is “timely,” or how that will be determined.

I have more than 40 years’ experience representing taxpayers in tax audits, and I am very concerned by the vagueness of these bills, and by the potential for significant penalties even when a taxpayer attempts to comply.

I urge you to hold this bill, or at least to study the issues in much more detail before taking any action.

SB-2377-HD-1

Submitted on: 4/4/2022 2:24:10 PM

Testimony for FIN on 4/6/2022 2:45:00 PM

Submitted By	Organization	Testifier Position	Testify
Gerard Silva	Individual	Oppose	Written Testimony Only

Comments:

Taxes are Illegal under the Constitution of America. You are violating the Law and should be put in Prison.!!