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To: The Honorable Sean Quinlan, Chair;
The Honorable Daniel Holt, Vice Chair;
and Members of the House Committee on Economic Development

From: Isaac W. Choy, Director
Department of Taxation

Date: Friday, March 18, 2022
Time: 10:30 A.M.
Place: Via Video Conference, State Capitol

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

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

S.B. 2377, S.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 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

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SUBJECT: ADMINISTRATION, Establish Civil Penalty for Failure to /Respond

BILL NUMBER: SB 2377 SD 1

INTRODUCED BY: Senate Committee on Ways & Means

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.

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.” 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.

If this bill is to go forward, consideration should be given to capping the penalty at 25% of the tax deficiency (the amount due under law less what was paid) as is the case with other penalties, instead of “any state taxes owed,” which could bring in debts entirely unrelated to the examination. Language also could be added to say that failures to respond to multiple rounds of information requests do not multiply the penalty cap; if not, the penalty could spiral out of control quickly.

Digested: 3/16/2022

SB-2377-SD-1

Submitted on: 3/16/2022 11:44:44 AM

Testimony for ECD on 3/18/2022 10:30:00 AM

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

Comments:

I am writing to express opposition to, and serious concerns about, SB 2377, which would impose penalties on a person who fails to “respond or reply” in a timely manner during a tax audit. First, SB 2377 says 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.

There is also 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 information 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 CPA 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.

An additional 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 information and/or documentation is that issues are resolved against the taxpayer.**

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 severe penalties even when a taxpayer attempts to comply.