

TAX FOUNDATION OF HAWAII

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SUBJECT: TAX APPEALS, Procedure for Payments Under Protest when Suit Brought Prematurely

BILL NUMBER: HB 1174

INTRODUCED BY: YAMASHITA

EXECUTIVE SUMMARY: Allows for the interest earned on payments under protest in the litigated claims fund to be paid in nontaxation cases if the claimant prevails. Establishes a procedure for the disposition of moneys and refiling of actions when a payment under protest suit is filed prematurely.

SYNOPSIS: Amends section 40-35, HRS, to provide that if a payment under protest suit is brought prematurely and the claimant's suit is dismissed, the claimant's payment may be retained in the litigated claims fund. If the agency then renders a final decision, the claimant has 30 days to refile the suit. If the agency does not render a final decision within 180 days after the date of the claimant's payment, the payment is to be refunded to the claimant with interest while the litigants await the agency's final decision.

Also provides that the interest to be paid is the interest earned on the payment by the litigated claims fund, as opposed to the flat 2% under current law.

EFFECTIVE DATE: Upon approval.

STAFF COMMENTS: *Grace Business Development Corporation v. Kamikawa*, 92 Haw. 608, 994 P.2d 540 (2000), held that if a taxpayer pays money under protest but then sues for a refund before the defendant agency has formally taken a position on whether the money is due, the appeal is to be dismissed. If the agency later decides that the money is indeed due, it is generally too late for the suit to be refiled (it needs to be filed within 30 days after the payment), potentially allowing the agency to keep the money whether or not the payment to the agency was legal. This bill prevents the Catch-22 situation described.

As an example, suppose a taxpayer is being audited. The auditor sends an email to the taxpayer directing him to pay \$10,000 in additional tax. The taxpayer pays the amount with a protest letter and files suit under HRS section 40-35. The Department responds that the auditor's email was not a formal agency determination, and the court dismisses the lawsuit. Assuming that 30 days have passed, under present law it appears that the taxpayer loses the money whether or not the taxpayer would have prevailed on the merits. Under the bill, the taxpayer's money is retained in the litigated claims fund for 180 days. If a Notice of Final Assessment is then issued, the taxpayer can refile the lawsuit with no additional payment (except for the court filing fee) within 30 days after the Notice. And if the agency does not decide within the 180 days, it must refund the money to the taxpayer; if the agency then issues a final assessment the taxpayer can then pay under protest and sue within 30 days.

The bill changes the interest rate payable when the taxpayer wins from a flat rate of 2% to the actual earnings on the special deposit, following the rule in *Hawaiian Trust Co. v. Smith*, 32 Haw. 38 (1931)., where the court held that when the taxpayer wins, the money in the special account is the taxpayer's money and the taxpayer should be entitled to the earnings on it.

Digested: 2/11/2025