

# H.B. NO. 1413

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## A BILL FOR AN ACT

RELATING TO TAX ADMINISTRATION.

**BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:**

1           SECTION 1. As a self-reporting system that relies upon the  
2 honesty and integrity of taxpayers, enforcement of Hawaii's tax  
3 laws is only as effective as the compliance tools that exist to  
4 deter dishonest conduct. Hawaii lacks a vast majority of the  
5 tools used by the Internal Revenue Service and its Criminal  
6 Investigations Division to investigate, prosecute, and deter  
7 criminal tax frauds. The purpose of this Act is to amend title  
8 14, Hawaii Revised Statutes, to conform Hawaii criminal tax  
9 administration provisions to the Internal Revenue Code.

10           This Act will assist the department of taxation's criminal  
11 enforcement unit, as well as the department of the attorney  
12 general and the prosecuting attorney offices of the respective  
13 counties, by providing these essential compliance tools. The  
14 tools provided by this Act include provisions relating to tax  
15 administration enforcement, criminal tax penalties, and tax  
16 fraud proceedings. This Act shall be known as "The Tax  
17 Compliance Omnibus Act of 2007."

1                   PART I. TAX ADMINISTRATION ENFORCEMENT

2           SECTION 2. Chapter 231, Hawaii Revised Statutes, is  
3 amended by adding a new section to be appropriately designated  
4 and to read as follows:

5           "§231- Understatement of taxpayer's liability by tax  
6 return preparer. (a) Any tax return preparer making  
7 understatements of liability based upon unrealistic positions on  
8 a tax return or claim for tax refund shall pay a penalty of  
9 \$250, with respect to each such tax return or claim, unless  
10 there is reasonable cause for the understatement and the tax  
11 return preparer acted in good faith.

12           (b) A tax return preparer wilfully or recklessly makes an  
13 understatement of liability based upon unrealistic positions on  
14 a tax return or claim for tax refund if the tax return preparer:

15           (1) Wilfully attempts to understate a person's tax  
16           liability; or

17           (2) Recklessly disregards any tax law or rule.

18 Any tax return preparer who violates this subsection shall pay a  
19 penalty of \$1,000, with respect to each such tax return or  
20 claim. Penalties assessed under this subsection shall be  
21 reduced by any penalties assessed under subsection (a).

1        (c) For purposes of subsections (a) and (b),  
2 understatements of liability using unrealistic positions occur  
3 when:

4        (1) Any part of a tax return or claim for tax refund is  
5 based on a position that does not have a realistic  
6 possibility of being sustained on its merits;

7        (2) Any tax return preparer who prepares a tax return or  
8 claim for tax refund knew or reasonably should have  
9 known of such an unrealistic position; and

10       (3) The unrealistic position was not a disclosed item as  
11 provided in subsection (h) or was frivolous.

12       (d) If within thirty days after the notice and demand of  
13 any penalty under subsection (a) or (b) is made, the tax return  
14 preparer:

15       (1) Pays an amount that is not less than fifteen per cent  
16 of the penalty amount; and

17       (2) Files a claim for refund of the amount so paid,  
18 no action to levy or file a proceeding in court to collect the  
19 remainder of the penalty shall be commenced except in accordance  
20 with subsection (e).

1       (e) An action that is stayed pursuant to subsection (d)  
2 may be brought thirty days after either of the following events,  
3 whichever occurs first:

4       (1) The tax return preparer fails to file an appeal to the  
5 tax appeal court within thirty days after the day on  
6 which the claim for refund of any partial payment of  
7 any penalty under subsection (a) or (b) is denied; or

8       (2) The tax return preparer fails to file an appeal to the  
9 tax appeal court for the determination of the tax  
10 return preparer's liability for the penalty assessed  
11 under subsection (a) or (b) within six months after  
12 the day on which the claim for refund was filed.

13 Nothing in this subsection shall be construed to prohibit any  
14 counterclaim for the remainder of the penalty in any proceeding.

15       (f) If there is a final administrative determination or a  
16 final judicial decision that the penalty assessed under  
17 subsection (a) or (b) should not apply, then that portion of the  
18 penalty assessed shall be voided. Any portion of the penalty  
19 that has been paid shall be refunded to the tax return preparer  
20 as an overpayment of tax without regard to any period of  
21 limitations which, but for this subsection, would apply to the  
22 making of the refund.

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1        (g) At the request of the director of taxation, a civil  
2 action may be brought to enjoin a tax return preparer from  
3 further acting as a tax return preparer or from engaging in  
4 conduct prohibited under subsection (a) or (b) as follows:

5        (1) Any action under this subsection may be brought in the  
6 circuit court of the circuit in which the tax return  
7 preparer resides or has a principal place of business,  
8 or in which the taxpayer with respect to whose tax  
9 return the action is brought resides;

10       (2) The court may exercise its jurisdiction over the  
11 action separate and apart from any other action  
12 brought by the State against the tax return preparer  
13 or taxpayer;

14       (3) If the court finds that a tax return preparer has  
15 engaged in conduct subject to penalty under subsection  
16 (a) or (b) and that injunctive relief is appropriate  
17 to prevent the recurrence of that conduct, the court  
18 may enjoin the preparer accordingly; and

19       (4) If the court finds that a tax return preparer has  
20 continually or repeatedly engaged in conduct  
21 prohibited under subsection (a) or (b) and that an  
22 injunction prohibiting that conduct would not be

1           sufficient to prevent the preparer's interference with  
2           the proper administration of this chapter, the court  
3           may enjoin the preparer from acting as a tax return  
4           preparer.

5           (h) For purposes of this section:

6           "Disclosed item" means any item where:

7           (1) The relevant facts affecting the item's tax treatment  
8           are adequately disclosed in a tax return or in a  
9           statement attached to a tax return; and

10          (2) There is a reasonable basis for the tax treatment of  
11          the item by the taxpayer.

12          "Tax return preparer" means any person who prepares,  
13          employs, or supervises one or more persons who prepare a tax  
14          return or a claim for tax refund. Preparation of a substantial  
15          portion of a tax return or claim for tax refund shall be treated  
16          as if it were the preparation of a tax return or claim for tax  
17          refund.

18          "Understatement of liability" means any understatement of  
19          the net amount payable for any tax imposed or any overstatement  
20          of the net amount creditable or refundable for any tax. Except  
21          as otherwise provided in subsection (f), the determination of  
22          whether there is an understatement of liability shall be made

1 without regard to any administrative or judicial action  
2 involving the taxpayer.

3 (i) The penalty imposed by this section shall be in  
4 addition to any other penalty provided by law."

5 SECTION 3. Chapter 231, Hawaii Revised Statutes, is  
6 amended by adding a new section to be appropriately designated  
7 and to read as follows:

8 "§231- Promoting abusive tax shelters. (a) A person  
9 promotes an abusive tax shelter by:

10 (1) Organizing or assisting in the organization of, or  
11 participating directly or indirectly in the sale of an  
12 interest in:

13 (A) A partnership or other entity;

14 (B) Any investment plan or arrangement; or

15 (C) Any other plan or arrangement; and

16 (2) In connection with any activity described under  
17 paragraph (1), making, furnishing, or causing another  
18 person to make or furnish, a statement with respect  
19 to:

20 (A) Whether any deduction or credit is allowed;

21 (B) Whether any income may be excluded; or

1           (C) The securing of any other tax benefit by reason  
2                   of holding an interest in the entity or  
3                   participating in the plan or arrangement,  
4           that the person knows or has reason to know is false or  
5           fraudulent or is a gross valuation overstatement as to any  
6           material matter.

7           (b) A person found promoting an abusive tax shelter shall  
8           pay, with respect to each activity described in subsection (a),  
9           a penalty of \$1,000 or, if the person establishes that it is  
10           less, one hundred per cent of the gross income derived or to be  
11           derived by the person from the activity. For purposes of this  
12           section, activities described in subsection (a)(1) shall be  
13           treated as a separate activity for each entity or arrangement.  
14           Participation in each sale described in subsection (a)(2) shall  
15           be treated as a separate activity for each entity or  
16           arrangement.

17           (c) At the request of the director, a civil action may be  
18           brought to enjoin any person described in subsection (a) from  
19           engaging in any conduct described in subsection (a). Any action  
20           under this section shall be brought in the circuit court of the  
21           circuit where the person in subsection (a) resides or where the  
22           person's principal place of business is located. The court may



1 exercise its jurisdiction over the action separate and apart  
2 from any other action brought by the State against those persons  
3 described in subsection (a). If the court finds that a person  
4 described in subsection (a) has engaged in any conduct subject  
5 to penalty under subsection (b) and that injunctive relief is  
6 appropriate to prevent the recurrence of that conduct, the court  
7 may enjoin the person accordingly.

8 (d) For purposes of this section, "gross valuation  
9 overstatement" means any statement of value for any property or  
10 services if:

11 (1) The value so stated exceeds two hundred per cent of  
12 the amount determined to be the correct valuation; and

13 (2) The value of the property or services is directly  
14 related to the amount of any deduction or credit  
15 allowable to any participant.

16 (e) The director may waive all or any part of the penalty  
17 provided by subsection (b) with respect to any gross valuation  
18 overstatement on a showing that there was a reasonable basis for  
19 the valuation and that the valuation was made in good faith.

20 (f) The penalty imposed by this section shall be in  
21 addition to any other penalty provided by law."

1                                   PART II. CRIMINAL TAX ENFORCEMENT

2           SECTION 4. Chapter 231, Hawaii Revised Statutes, is  
3 amended by adding a new section to be appropriately designated  
4 and to read as follows:

5           "§231- Wilful failure to collect and pay over tax. Any  
6 person required to collect, account for, and pay over any tax  
7 imposed by title 14, who wilfully fails to collect or truthfully  
8 account for and pay over such tax shall, in addition to other  
9 penalties provided by law, be guilty of a class C felony and,  
10 upon conviction, shall be subject to one or any combination of  
11 the following:

12           (1) A fine of not more than \$100,000;

13           (2) Imprisonment of not more than five years; or

14           (3) Probation;

15 provided that a corporation shall be fined not more than  
16 \$500,000."

17                                   PART III. TAX FRAUD PROCEEDINGS

18           SECTION 5. Chapter 231, Hawaii Revised Statutes, is  
19 amended by adding a new section to be appropriately designated  
20 and to read as follows:

21           "§231- Signature presumed authentic. The fact that an  
22 individual's name is signed on a return, statement, or other

1 document shall be prima facie evidence for all purposes that the  
2 return, statement, or other document was actually signed by the  
3 individual."

4 SECTION 6. Section 235-111, Hawaii Revised Statutes, is  
5 amended by amending subsection (c) to read as follows:

6 "(c) Exceptions; fraudulent return or no return. In the  
7 case of a false or fraudulent return with intent to evade tax or  
8 liability, or of a failure to file return, the tax or liability  
9 may be assessed or levied at any time[~~; provided that in the~~  
10 ~~ease of a return claimed to be false or fraudulent with intent~~  
11 ~~to evade tax or liability, the determination as to the claim~~  
12 ~~shall first be made by a judge of the circuit court for or in~~  
13 ~~the circuit within which the taxpayer or employer has the~~  
14 ~~taxpayer's or employer's residence or principal place of~~  
15 ~~business, or if none in the State then in the first circuit,~~  
16 ~~upon petition filed by the department of taxation. The petition~~  
17 ~~and other pleadings and proceedings in the matter shall be~~  
18 ~~governed and conducted in accordance with statutory and other~~  
19 ~~requirements relating to proceedings in equity, including all~~  
20 ~~rights to appeal allowed in the proceedings. No assessment or~~  
21 ~~levy of the tax or liability after the expiration of the three-~~

1 ~~year period shall be made unless so provided in the final decree~~  
2 ~~entered in the proceedings]."~~

3 SECTION 7. Section 237-40, Hawaii Revised Statutes, is  
4 amended by amending subsection (b) to read as follows:

5 "(b) Exceptions. In the case of a false or fraudulent  
6 return with intent to evade tax, or of a failure to file the  
7 annual return, the tax may be assessed or levied at any time[  
8 ~~however, in the case of a return claimed to be false or~~  
9 ~~fraudulent with intent to evade tax, the determination as to the~~  
10 ~~claim shall first be made by a judge of the circuit court as~~  
11 ~~provided in section 235-111(c) which shall apply to the tax~~  
12 ~~imposed by this chapter]."~~

13 SECTION 8. Section 237D-9, Hawaii Revised Statutes, is  
14 amended by amending subsection (d) to read as follows:

15 "(d) In the case of a false or fraudulent return with  
16 intent to evade tax, or of a failure to file the annual return,  
17 the tax may be assessed or levied at any time[  
18 ~~however, in the case of a return claimed to be false or fraudulent with intent~~  
19 ~~to evade tax, the determination as to the claim shall first be~~  
20 ~~made by a judge of the circuit court as provided in section 235-~~  
21 ~~111(c) which shall apply to the tax imposed by this chapter]."~~

1 SECTION 9. Section 243-14, Hawaii Revised Statutes, is  
2 amended by amending subsection (c) to read as follows:

3 "(c) In the case of a false or fraudulent statement with  
4 intent to evade tax or liability, or of a failure to file a  
5 statement, the tax or liability may be assessed or levied at any  
6 time [~~; provided that in the case of a statement claimed to be~~  
7 ~~false or fraudulent with intent to evade tax or liability, the~~  
8 ~~determination as to the claim shall first be made by a judge of~~  
9 ~~the circuit court as provided in section 235-111(e) which shall~~  
10 ~~apply to the tax imposed by this chapter]."~~

11 SECTION 10. Section 251-8, Hawaii Revised Statutes, is  
12 amended by amending subsection (d) to read as follows:

13 "(d) In the case of a false or fraudulent return with  
14 intent to evade the surcharge tax, or of a failure to file the  
15 annual return, the surcharge tax may be assessed or levied at  
16 any time [~~; however, in the case of a return claimed to be false~~  
17 ~~or fraudulent with intent to evade the surcharge tax, the~~  
18 ~~determination as to the claim shall first be made by a judge of~~  
19 ~~the circuit court as provided in section 235-111(e) which shall~~  
20 ~~apply to the surcharge tax imposed by this chapter]."~~

21 SECTION 11. This Act does not affect returns prepared and  
22 transactions promoted, rights and duties that matured, penalties

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1 that were incurred, and proceedings that were begun, before its  
2 effective date.

3 SECTION 12. Statutory material to be repealed is bracketed  
4 and stricken. New statutory material is underscored.

5 SECTION 13. This Act shall take effect on July 1, 2007.

6  
7 INTRODUCED BY: \_\_\_\_\_

*Calvin K. Y. Day*

8 BY REQUEST

JAN 22 2007

JUSTIFICATION SHEET

DEPARTMENT: Taxation

TITLE: A BILL FOR AN ACT RELATING TO TAX ADMINISTRATION.

PURPOSE: To conform Hawaii tax law to federal tax law relating to tax administration and criminal tax enforcement.

MEANS: Add five new sections to chapter 231, Hawaii Revised Statutes (HRS), and amend sections 235-111(c), 237-40(b), 237D-9(d), 243-14(c), and 251-8(d), HRS.

JUSTIFICATION: This bill is to be known as the "Tax Compliance Omnibus Act of 2007."

A. TAX RETURN PREPARERS

The overall duty of a preparer is to prepare a proper return. The preparer can generally rely in good faith on information furnished by the taxpayer without verification. The preparer is not required to audit, examine, or review books and records, business operations, documents, or other evidence in order to verify independently the taxpayer's information.

The preparer, however, cannot ignore the implications of information furnished to or actually known by the preparer. If the information furnished appears to be incorrect or incomplete, the preparer must make reasonable additional inquiries.

In addition, the preparer must make appropriate inquiries to determine whether the taxpayer has the substantiation required for certain deductions (e.g., travel and entertainment expenses).

This bill imposes penalties of \$250 for an undisclosed, unrealistic position, and \$1,000 for willful or reckless disregard of the law. The department may also seek injunctive relief to prevent certain recurring conduct. These penalties are drawn from Internal Revenue Code (IRC) sections 6694 and 7407.

#### B. ABUSIVE TAX SCHEME PROMOTERS

This bill proposes another penalty and injunctive relief (drawn from IRC sections 6700 and 7407) that apply to two distinct types of conduct: (1) making a false statement; and (2) making a "gross valuation overstatement."

The penalty is applicable to any "person" who, directly or indirectly, organizes or assists in the organization of a tax shelter or who participates in the sale of any interests in a shelter. Although the penalty is aimed at individuals organizing and marketing interests in limited partnership tax shelters, the coverage is much broader. Any person--an individual, a corporation, a partnership, a trust, or an estate--can be a promoter. The tax shelter may be in the form of any entity, plan, or arrangement from which a tax benefit may be derived. Moreover, the plan or arrangement need not be an investment; it can include other activities, such as the sale of mail-order ministries or family trust arrangements.

#### C. SIGNATURES PRESUMED AUTHENTIC

Almost every form filed with the department must be signed by the taxpayer recognizing the penalties allowed for false or fraudulent statements made in connection with a return. The department relies in good faith that the signatures are authentic and intended to be signed as proffered. By



having a presumption that the signature as it appears on the document is authentic, the department will be greatly relieved of what has shown to be an unnecessary administrative burden, which requires prosecutors and investigators to either establish that a taxpayer signed the return or attempt to prove such through time consuming proceedings. This bill proposes to conform to IRC section 6064, which creates a presumption that any signature on a return or other document is presumed authentic. This mechanism places the burden of showing that the signature is false or fraudulent on the taxpayer, who is the most logical party and in the best position to establish whether or not the signature on the return is authentic.

#### D. FAILURE TO COLLECT AND PAY

Every individual or entity with a tax liability is required by law to pay over that tax liability as provided in Title 14, HRS. This bill proposes a conformity provision to IRC section 7202, which provides a felony offense for anyone to willfully fail to collect, truthfully account for, or pay over any tax. Title 14, HRS, is presently void of criminal liability for failure to properly collect, truthfully account for, and pay over taxes owed. Failure to pay tax or other similar criminal actions are presently charged and prosecuted under a theft theory.

#### E. ASSESSMENT AND LEVY UPON FRAUDULENT RETURNS

Certain HRS sections are amended to conform to the federal assessment provision at section 6501, IRC. Conforming to such will allow the department to assess and levy at any time where taxpayers file a fraudulent return or do not file a return. Currently, section 235-111, HRS, requires a court

determination that a taxpayer filed a false or fraudulent return before the department may assess or levy the associated tax or liability. This requirement is especially burdensome where a taxpayer enters a guilty plea that does not result in a court determination.

Impact on the public: The public is impacted only to the extent that Hawaii tax law now conforms to present federal tax law.

Impact on the department and other agencies: The Department of Taxation Criminal Investigation Section, the Department of the Attorney General, and the county prosecuting attorney offices will be equipped with the often-utilized and fundamental tax enforcement tools used by the Internal Revenue Service and other similar state tax agencies.

GENERAL FUND: None.

OTHER FUNDS: None.

PPBS PROGRAM  
DESIGNATION: TAX 100.

OTHER AFFECTED  
AGENCIES: Department of the Attorney General; County Prosecuting Attorney Offices.

EFFECTIVE DATE: July 1, 2007.