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SENATE COMMITTEE ON JUDICIARY & GOVERNMENT OPERATIONS

TESTIMONY REGARDING SB 118 RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)

DATE: FEBRUARY 10, 2009

TIME: 9AM

ROOM: 016

This bill proposes to create a 10-year statute of limitations for collection of various taxes. This bill also seeks to clarify tax law to provide a three-year statute of limitations for assessment on general excise, use, and other periodic returns, by providing for the limitations period to begin upon the filing of the earliest respective periodic return.

The Department of Taxation (Department) opposes this legislation.

I. PROPOSED 10-YEAR STATUTE OF LIMITATIONS

This legislation will greatly impact the Department's ability to levy and collect unpaid taxes. Presently, the Department is entitled to an unlimited statute of limitations for uncollected taxes, which provides a material benefit to the general fund.

The Department is opposed to amending Hawaii tax law to provide for a collection statute of limitations of 10 years. Proponents of such an amendment argue that the ability to substantiate return information and collection issues erodes over time. The Department does not contend that a 10-year statute of limitations is unreasonable. The Department also agrees that a statute of limitations on collection is good tax policy. However, the Department believes now is not the time to consider such a change given the State's current fiscal crisis. Also, the Department prefers the unlimited statute of limitations because it is possible for a taxpayer to be unable to pay the assessed tax for several years and later become solvent to the extent that full recovery of taxes owed is possible. By adopting a hard collection window, the Department will be forced to shut down businesses.

Especially with regard to larger tax liabilities, it may take decades for a taxpayer to accumulate sufficient wealth to be able to pay their tax bill. Similarly, with regard to businesses, the Department suggests that by forcing the Department to levy and collect within 10 years likely hampers a business' ability to be profitable and generate revenues over time and later have the ability to settle any outstanding liabilities. The Department will be forced to pursue more foreclosures and

seizures of businesses to comply with the 10-year statute thereby resulting in the closure of those businesses, rather than the Department working with those businesses to pay the tax.

II. THREE-YEAR STATUTE OF LIMITATIONS ON ASSESSMENT ON PERIODIC RETURNS

The Department opposes this suggestion. The law clearly requires all taxpayers subject to various periodic tax return liabilities to file an annual reconciliation return. It is an unacceptable argument to claim that it is "not fair" for the statute of limitations to toll if a taxpayer "forgot" to file the annual return after diligently filing the periodic returns.

Tax law is clear and the Department's forms and instructions aid taxpayers by setting forth the requirements of the general excise tax filing requirements. Just as the federal government begins the statute of limitations for income tax returns at the date due or when filed, whichever is later; the Department likewise believes it is justified in beginning the running of the statute of limitations when a taxpayer's obligations under the law are closed upon the filing of the annual reconciliation and not earlier.

The periodic filings were never intended to begin a statute of limitations. The periodic return requirement is simply to ensure a consistent revenue stream into the treasury. Because of certain business activities that occur from time-to-time, such as refunds of merchandise, the annual reconciliation allows for these disparities to be accounted for at which point the statute begins to run—when all business activities of revenues and proceeds has settled for the taxable year.

III. CRITICAL NEED FOR COMMITTEE TO CONSIDER REVENUE LOSS; CONSIDER ADOPTING OFFSETS TO REVENUE LOSS; AND OTHER TOLLING PROVISIONS FOR STATUTES OF LIMITATIONS

Assuming the Committee is inclined to pass this measure out of committee for further discussion, the Department raises three important issues for the Committee's consideration:

REVENUE LOSS IS LARGE—This legislation could result in a large revenue loss that is contrary to the State's fiscal interests. During a time where some consider the fiscal outlook of the State tight, it is important to factor in the substantial revenue loss posed by this bill. The revenue loss is projected to be at least \$10 million per year.

OFFSETS ARE CRITICAL—In order to offset the revenue lost from this measure, as well as to ensure fairness in overall tax administration in light of this measure, the Department suggests that the Committee amend this measure to include the provisions of the Department's penalty conformance measure, SB 973. SB 973 adopts several of the penalties available on the federal level that are not available on the state level. For example, these penalties could include:

- **IRC § 6662 Accuracy Related Underpayment Penalty**
- **IRC § 6672 Failure to Collect and Pay Over Tax Penalty**
- **IRC § 6676 Erroneous Refund Penalty**
- **IRC § 6694 Understatement of Liability by Preparer Penalty**
- **IRC § 6700 Abusive Tax Shelter Promoter Penalty**

Only after the State tax law has been amended to appropriately adopt the penalties on the federal

level should the Legislature consider lowering the standards for taxpayers. Currently, standards of conduct are substantially different for taxpayers and practitioners before the IRS and the Department. There is no reason for there to be substantially differing "playing fields," and, until such a reconciliation, the Department suggests this bill be held until such penalties are instituted to offset the revenue loss from this measure.

PHASE IN THE STATUTE OF LIMITATIONS—As stated above, the Department does not find the 10 year statute of limitations unreasonable or contrary to good tax policy. The State simply cannot afford such a drastic change at this time. The Department suggests phasing in the state statute of limitations by allowing all current assessments an unlimited collection statute. And, begin the phase-in at 20 years, then 15 years, then 10 over time so that the Department has the ability properly amend its procedures for collecting taxes.

THE STATUTE OF LIMITATIONS MUST TOLL SIMILAR TO THE FEDERAL STATUTE—The intent appears to be to conform to the federal 10-year statute of limitations. If this is the legislative will, the bill must be amended to include the tolling features that the IRS has at its disposal in order to ensure proper revenue collection. The statute of limitations must be amended to toll during the following events, as provided under § 6502, IRC:

- **Where the taxpayer and government agree to toll the statute;**
- **Where the taxpayer is bankrupt and later able to be recovered against; and**
- **Where the government is able to reduce the tax debt to a judgment and pursue the debt through judicial channels.**

Please add the following language at the end of each amended chapter—

Where the assessment of the tax imposed by this chapter has been made within the period of limitation properly applicable thereto, the tax may be collected by levy or by a proceeding in court; provided that the levy is made or the proceeding was begun within XX years after the assessment of the tax.

Notwithstanding any other provision to the contrary in this section, the limitation on collection after assessment in this section shall be suspended for the period the assets of the taxpayer are in the control or custody of a court in any proceeding before any court of the United States or of any state, and for six months thereafter. In addition, the running of the period of limitations after assessment shall be suspended for the period during which the taxpayer is outside the State if such period of absence is for a continuous period of at least six months. If the preceding sentence applies and at the time of the taxpayer's return to the State the period of limitations on collection after assessment would expire before the expiration of six months from the date of the taxpayer's return, such period shall not expire before the expiration of such six months.



**Testimony to the Senate Committee on Judiciary and Government Operations
Tuesday, February 10, 2009 at 9:00 a.m.
Room 016, State Capitol**

RE: S.B. 118 Relating to Taxation

Chair Taniguchi, Vice Chair Takamine, and Members of the Committee:

My name is Jim Tollefson, President and CEO of The Chamber of Commerce of Hawaii. The Chamber supports Senate Bill 118.

The Chamber is the largest business organization in Hawaii, representing more than 1,100 businesses. Approximately 80% of our members are small businesses with less than 20 employees. The organization works on behalf of members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

We urge your support of this measure, which: (1) imposes a 10-year statute of limitations on tax collections (Hawaii has no statute of limitations on collections); (2) starts the running of the statute of limitations on assessments from the filing of the earlier of the filing of the periodic or annual returns, not just the annual return as under current law.

Under current law, Hawaii has no statute of limitations on collections, which means that the Department of Taxation can pursue a taxpayer until death or dissolution/bankruptcy. Ten years from the date of assessment, which is the federal government's statute of limitations on collections, should be enough time for the Department to act and collect delinquent taxes, and would ensure some measure of urgency in collecting delinquent taxes. Taxpayers would also be assured that they can have a fresh start after a period of time. We note that Hawaii is one of only four states that provide for no statute of limitations on collections.

Thank you for the opportunity to submit testimony.



H S C P A

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Certified Public Accountants

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February 9, 2009

Honorable Brian Taniguchi, Chair
Committee on Judiciary & Government Operations
Hawaii State Capital, Room 016
415 South Beretania Street
Honolulu, Hawaii 96813

RE: Hearing February 10, 2009 Senate Bill 118 – Relating to Taxation

Dear Chair Taniguchi, Vice-Chair Takamine, Members of Committee:

On behalf of the Hawaii Society of Certified Public Accountants (HSCPA) Tax Committee, I am writing to ask for your support for SB 118 which is equitable and ultimately revenue neutral.

Intent of the Proposed Legislation

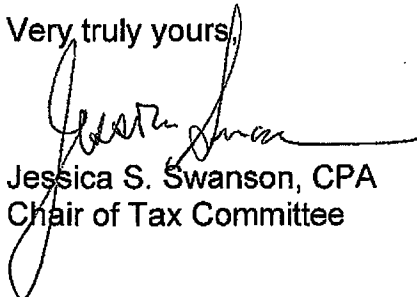
- Impose a 10-year statute of limitations on tax collections which is equivalent to the federal tax law since Hawaii has no statute of limitations on collections; and

Rationale for the Proposed Legislation

- Establish and conform Hawaii's statute of limitations on collections to the ten years established by the federal government. Under current law, Hawaii has no statute of limitations on collection of assessed taxes, which means Hawaii can pursue a taxpayer forever on collections short of bankruptcy. Also, the ten years statute of limitation collection period will provide the Department of Taxation with an incentive to expedite collection efforts which ultimately benefits the State since the value of a receivable diminishes with time.

Passage of Senate Bill 118 will promote fairness and simplification for the people of Hawaii and enhance administration and collection of tax by the Department of Taxation.

Very truly yours,


Jessica S. Swanson, CPA
Chair of Tax Committee

ANDREW V. BEAMAN
ANDREW R. BUNN
ANDREW W. CHAR
LEROY E. COLÔMBE
RAY K. KAMIKAWA
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THE SENATE
THE TWENTY-FIFTH LEGISLATURE
REGULAR SESSION OF 2009

COMMITTEE ON JUDICIARY AND GOVERNMENT
OPERATIONS

Hearing date: February 10, 2009
Testimony on SB 118
(Relating to Taxation)

Chair Taniguchi, Vice-Chair Takamine, members of the Committee:

We urge your support of this measure, which imposes a 10-year statute of limitations on delinquent tax collections.

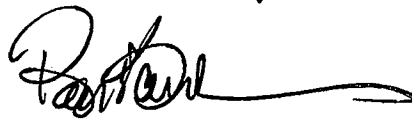
Hawaii has no statute of limitations on delinquent tax collections, which means that the Department of Taxation can pursue a taxpayer until death or dissolution/bankruptcy. Ten years from the date of assessment, which is the federal government's statute of limitations, should be enough time for the Department to act and collect delinquent taxes, and would ensure some measure of urgency in collecting delinquent taxes. Taxpayers would also be assured that they can have a fresh start after a period of time.

The federal government has a 10-year statute of limitations on collections of delinquent taxes. Hawaii is currently one of only four states that does not have some form of statute of limitations on collections.

We note that this bill contains remnants of last year's version providing for a modification to the statutes of limitation for the three-year assessment period, which provisions should be deleted from the bill.

Very truly yours,

CHUN, KERR, DODD, BEAMAN & WONG,
a Limited Liability Law Partnership



Ray Kamikawa

**THE SENATE
THE TWENTY-FIFTH LEGISLATURE
REGULAR SESSION OF 2009**

COMMITTEE ON JUDICIARY AND GOVERNMENT OPERATIONS

**Hearing date: February 10, 2009
Testimony on SB 118
(Relating to Taxation)**

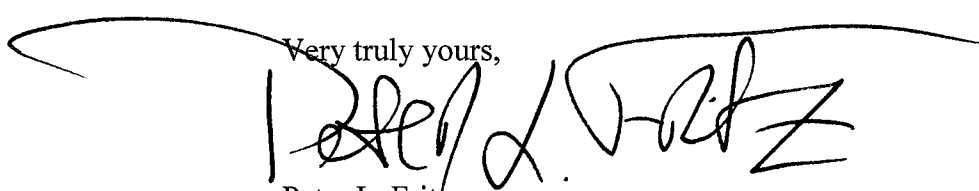
Chair Taniguchi, Vice-Chair Takamine, members of the Committee:

I support this measure which: (1) imposes a 10-year statute of limitations on tax collections (Hawaii has no statute of limitations on collections); and (2) starts the running of the statute of limitations on assessments from the earlier of the filing of the periodic or annual returns, not just the annual return as under current law.

(1) Conform Hawaii's statute of limitations on collections of delinquent taxes to that of the federal government's 10 years. Under current law, Hawaii has no statute of limitations on collections, which means that the Department of Taxation can pursue a taxpayer until death or dissolution/bankruptcy. Ten years from the date of assessment, which is the federal government's statute of limitations on collections, should be enough time for the Department to act and collect delinquent taxes, and would ensure some measure of urgency in collecting delinquent taxes. Taxpayers would also be assured that they can have a fresh start after a period of time.

(2) The three-year statute of limitations on assessment of the GET and other periodic returns should not run only from the filing of the annual reconciliation return. Time and again taxpayers who have filed their periodic returns (monthly, quarterly, semi-annually) on time with full payment of taxes owed are unaware that they must also file the annual reconciliation return due the following April 20 even though no additional tax is owed for the year. Under current law, the three-year statute of limitations only begins to run from the filing of this annual return no matter that all periodic returns and taxes were paid, giving the Department the power to assess taxes that can go back far more than three years. This bill requires that the three-year statute of limitations starts to run from the filing of each periodic return or the annual return, whichever is earlier.

Very truly yours,


Peter L. Fritz

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**THE SENATE
THE TWENTY-FIFTH LEGISLATURE
REGULAR SESSION OF 2009**

COMMITTEE ON JUDICIARY AND GOVERNMENT OPERATIONS

Hearing date: February 10, 2009
Testimony on SB 118
(Relating to Taxation)

Chair Taniguchi, Vice-Chair Takamine, members of the Committee:

I urge you to support this measure.

The purpose of this bill is to correct an apparent oversight in Hawaii's income (and other) tax law for the benefit of Hawaii's taxpayers.

As Honorable Members are aware, statutes of limitation serve a valuable purpose in protecting persons from stale claims and providing certainty of outcomes, among other beneficial aspects.

Honorable Members should be advised that the 10 year statute of limitations only starts upon "assessment." "Assessment" is a carefully defined term in existing law and generally means the filing of the appropriate return or the culmination of an audit, examination, or Department of Taxation assessment procedure.

Persons that do not file their tax returns will not be protected by this measure. This measure in no manner provides a "free ride" or windfall for persons operating "off the books" and not participating in the tax system.

Sincerely,



Richard McClellan

Ronald I. Heller
Attorney & CPA

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Before the Senate Committee on Judiciary & Government Operations

Tuesday, February 10, 2009
9:00 am
Conference Room 016

Re: SB 118
Relating to Taxation

Testimony of Ronald I. Heller

Chair Taniguchi, Vice Chair Takamine, and Committee members:

Thank you for the opportunity to testify. I support SB 118.

If you owe money to the Internal Revenue Service, they have 10 years to collect it. Under certain circumstances, that 10 year period can be extended, but at some point, if the IRS hasn't acted, it simply becomes too late.

Our state tax law, in contrast, contains no limitation period for the Department of Taxation. I have seen cases where they've pursued collection 20 years, or 25 years, after the tax liability originally accrued. Generally, taxpayers do not have good records going that far back, and these cases are usually difficult to resolve.

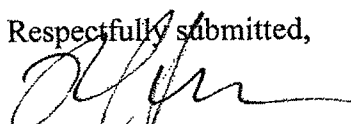
Moreover, the absence of any time limit may encourage an "it can wait" attitude on the part of some Tax Department employees – instead of taking prompt action, they feel they can take their time.

Therefore, imposing a ten-year statute of limitations – the **same** limitation period that exists for federal taxes – would benefit both taxpayers and the State. Taxpayers would no longer

face the threat of trying to defend against claims that go back for decades, and the State would see a greater emphasis on prompt action with respect to tax collections.

Thank you for your attention to this matter.

Respectfully submitted,



Ronald I. Heller