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**HOUSE COMMITTEE ON JUDICIARY  
TESTIMONY REGARDING SB 2752 SD 1  
RELATING TO TAX ADMINISTRATION**

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

**DATE: MARCH 16, 2010**

**TIME: 2:15PM**

**ROOM: 325**

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This measure provides for a cost recovery order issuable by a circuit court for investigation costs when a taxpayer is convicted of a tax crime. As amended, this measure allows for the assessment of "reasonable" investigation costs, rather than actual investigation costs.

The Department of Taxation (Department) **strongly supports** this measure; however **prefers its original contents.**

The purpose of this measure is to provide for the mandatory assessment of administrative costs associated with investigating tax crimes when a taxpayer is convicted of a tax offense or has a conviction deferred. This measure serves as further deterrence for tax evasion and other similar behavior.

A tax system is only as effective as the deterrence mechanisms available to curb its abuse. When jail sentences are impractical or convictions are deferred, the criminal deterrence mechanism is reduced. This measure boosts the deterrence by requiring criminals to pay for the cost of investigating their crimes.

# TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

**SUBJECT:** ADMINISTRATION, Assessment of administrative costs

**BILL NUMBER:** SB 2752, SD-1

**INTRODUCED BY:** Senate Committee on Ways and Means

**BRIEF SUMMARY:** Adds a new section to HRS chapter 231 to provide that any person who is convicted or granted a deferred acceptance of plea of an offense under section HRS 231-34, 231-35, 231-36, or 231-36.4 shall, in addition to any other penalties, be assessed by the court the reasonable cost of investigating the violation. Any costs recovered under this section shall be deposited into the tax administration special fund.

Makes conforming amendments to HRS section 235-20.5.

The amendments made to section HRS 235-20.5, by this act shall not be repealed when: (1) HRS section 235-20.5 is reenacted on January 1, 2011, pursuant to section 8 of Act 206, SLH 2007; or (2) HRS section 235-20.5 is reenacted on June 30, 2014, pursuant to section 13 paragraph 3 of Act 134, SLH 2009.

**EFFECTIVE DATE:** July 1, 2055

**STAFF COMMENTS:** This measure was an administration measure submitted by the department of taxation TAX-13(10). While this measure would allow the department of taxation to recover the cost of investigating any tax crime when a taxpayer is convicted or is granted a deferred acceptance of guilty plea, a limitation on the amount that may be assessed should be established or such amount may be greater than the fine imposed for the tax crime.

If this measure is to be enacted, then consideration should be given to awarding a defendant taxpayer who is successful in contesting an assessment the cost of his defense. It is indeed sad that the state government has sunk to the level of nickel and diming taxpayers for services that should otherwise be paid out of the general revenues of the state. Further, it should be remembered that if the idea of this proposal is to punish the scofflaw, there are charges for penalties and interest if the taxpayer is found to be in violation of the law.

Digested 3/15/10

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**THE HOUSE OF REPRESENTATIVES  
THE TWENTY-FIFTH LEGISLATURE  
REGULAR SESSION OF 2010**

**COMMITTEE ON JUDICIARY**

**Hearing March 16, 2010  
Testimony on S.B. 2752 SD1**

(Relating To Tax Administration)

Chair Karamatsu, Vice Chair Ito and members of the Committee:

My name is Peter Fritz. I am an attorney specializing in taxation. I was also an administrative rules specialist with the Department of Taxation ("Department"). I am testifying in my personal capacity **opposition** to S.B. 2752 SD1; however, if the Committee decides not to hold this measure, I offer language that will allow a prevailing taxpayer to collect fees and costs from the Department.

The purpose of this measure is to provide for the mandatory assessment of administrative costs associated with investigating tax crimes where a taxpayer is convicted of a tax offense or has a plea of guilty or no contest deferred.

- Assessing the costs of an investigation is tantamount to charging citizens for calling 911 to report an emergency.
- It is unlikely that the Department will be able to collect from someone in prison.
- In many cases, the cost of the defense will exceed the amount assessed and a person will offer a no contest plea because the financial burden will be less. Even if someone can recover attorney fees, the hazards of litigation may cause someone to enter a no contest plea. Cost recovery should not apply to no contest pleas.
- Allowing cost recovery could promote the filing of borderline cases because investigators may be evaluated by the amounts that are successfully recovered. It would be similar to rewarding police officers for the number of tickets that they write.

If the Committee does not defer this measure, than it should consider incorporating language that is similar to the cost recovery provisions in Internal Revenue Code Section 7430. Attached, as Exhibit A, is language that can be incorporated into this measure to allow a prevailing taxpayer to be awarded attorney fees and costs. Exhibit B is IRC §7430

Thank you for the opportunity to testify.

Respectfully submitted,



Peter L. Fritz

**A**

§ 231-\_\_ Awarding of costs and certain fees.

(a) In general. In any administrative or court proceeding which is brought by or against the State in connection with the determination, collection, or refund of any tax, interest, or penalty under this Title, the prevailing taxpayer may be awarded a judgment or a settlement for—

(1) reasonable administrative costs incurred in connection with such administrative proceeding within the Department of Taxation, and

(2) reasonable litigation costs incurred in connection with such court proceeding.

(b) Limitations. (1) Requirement that administrative remedies be exhausted. A judgment for reasonable litigation costs shall not be awarded under subsection (a) in any court proceeding unless the court determines that the prevailing taxpayer has exhausted the administrative remedies available to such taxpayer within the Department of Taxation. Any failure to agree to an extension of the time for the assessment of any tax shall not be taken into account for purposes of determining whether the prevailing taxpayer meets the requirements of the preceding sentence.

(2) Only costs allocable to the Department of Taxation. An award under subsection (a) shall be made only for reasonable litigation and administrative costs.

(3) Costs denied where taxpayer protracts proceedings. No award for reasonable litigation and administrative costs may be made under subsection (a) with respect to any portion of the administrative or court proceeding during which the prevailing taxpayer has unreasonably protracted such proceeding.

(4) Period for applying to the Department of Taxation for administrative costs. An award may be made under subsection (a) by the Department of Taxation for reasonable administrative costs only if the prevailing taxpayer files an application with the Department of Taxation for such costs before the 91st day after the date on which the final decision of the Department of Taxation as to the determination of the tax, interest, or penalty is mailed to such taxpayer.

(c) Definitions. For purposes of this section —

(1) Reasonable litigation costs. The term “reasonable litigation costs” includes—

(A) reasonable court costs, and

(B) based upon prevailing market rates for the kind or quality of services furnished—

(i) the reasonable expenses of expert witnesses in connection with a court proceeding,

(ii) the reasonable cost of any study, analysis, engineering report, test, or project which is found by the court to be necessary for the preparation of the taxpayer's case, and

(iii) reasonable fees paid or incurred for the services of attorneys in connection with the court proceeding, except that such fees shall not be in excess of \$300 per hour unless the court determines that a special factor, such as the limited availability of qualified attorneys for such proceeding, the difficulty of the issues presented in the case, or the local availability of tax expertise, justifies a higher rate.

(2) Reasonable administrative costs.

The term "reasonable administrative costs" means—

(A) any administrative fees or similar charges, and

(B) expenses, costs, and fees described in paragraph (1)(B).

Such term shall only include costs incurred on or after whichever of the following is the earliest: (i) the date of the receipt by the taxpayer of the notice of the decision of the Department of Taxation of Appeals; (ii) the date of the notice of deficiency; or (iii) the date on which the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Department of Taxation Office of Appeals is sent.

(3) Attorneys' fees.

(A) In general. For purposes of paragraphs (1) and (2), fees for the services of an individual (whether or not an attorney) who is authorized to practice before the Tax Court or before the Department of Taxation shall be treated as fees for the services of an attorney.

(B) Pro bono services. The court may award reasonable attorneys' fees under subsection (a) in excess of the attorneys' fees paid or incurred if such fees are less than the reasonable attorneys' fees because an individual is representing the prevailing taxpayer for no fee or for a fee which (taking into account all the facts and circumstances) is no more than a nominal fee. This subparagraph shall apply only if such award is paid to such individual or such individual's employer.

(4) Prevailing taxpayer.

(A) In general. The term “prevailing taxpayer” means any taxpayer in any proceeding to which subsection (a)

(i) which—

(I) has substantially prevailed with respect to the amount in controversy, or

(II) has substantially prevailed with respect to the most significant issue or set of issues presented, and

(B) Exception if Department of Taxation establishes that its position was substantially justified.

(i) General rule. A taxpayer shall not be treated as the prevailing taxpayer in a proceeding to which subsection (a) applies if the Department of Taxation establishes that the position of the Department of Taxation in the proceeding was substantially justified.

(ii) Presumption of no justification if Department of Taxation did not follow certain published guidance. For purposes of clause (i), the position of the Department of Taxation shall be presumed not to be substantially justified if the Department of Taxation did not follow its applicable published guidance in the administrative proceeding. Such presumption may be rebutted.

(iii) Effect of losing on substantially similar issues. In determining for purposes of clause (i) whether the position of the Department of Taxation was substantially justified, the court shall take into account whether the Department of Taxation has lost on substantially similar issues.

(iv) Applicable published guidance. For purposes of clause (ii), the term “applicable published guidance” means—

(I) Administrative Rules, Tax Information Releases, Notices, and Announcements.

(II) any of the following which are issued to the taxpayer: letter rulings, Comfort Rulings, opinion letters, and determination letters.

(C) Determination as to prevailing taxpayer. Any determination under this paragraph as to whether a taxpayer is a prevailing taxpayer shall be made by agreement of the parties or—

(i) in the case where the final determination with respect to the tax, interest, or penalty is made at the administrative level, by the Department of Taxation's Appeals Officer, or

(ii) in the case where such final determination is made by a court or if the Department of Taxation has not designated a Tax Appeals Officer, a court.

(5) Administrative proceedings.

The term "administrative proceeding" means any procedure or other action before the Department of Taxation.

(6) Court proceedings. The term "court proceeding" means any civil action brought in a court of the State of Hawaii.

(7) Position of the Department of Taxation. The term "position of the Department of Taxation" means—

(A) the position taken by the Department of Taxation in a judicial proceeding to which subsection (a) applies, and

(B) the position taken in an administrative proceeding to which subsection (a) applies as of the earlier of—

(i) the date of the receipt by the taxpayer of the notice of the decision of the Department of Taxation, or

(ii) the date of the notice of deficiency.

(d) Right of appeal.

(1) Court proceedings. An order granting or denying (in whole or in part) an award for reasonable litigation or administrative costs under subsection (a) in a court proceeding, may be incorporated as a part of the decision or judgment in the court proceeding and shall be subject to appeal in the same manner as the decision or judgment.

(2) Administrative proceedings. A decision granting or denying (in whole or in part) an award for reasonable administrative costs under subsection (a) by the Department of Taxation shall be subject to the filing of a petition for review with the Tax Appeal Court.

(3) Appeal of Tax Appeal Court decision. An order of the Tax Appeal Court disposing of a petition under paragraph (2) shall be reviewable in the same manner as a decision of the Tax Appeal Court, but only with respect to the matters determined in such order.

**B**

Checkpoint Contents

Federal Library

Federal Source Materials

Code, Regulations, Committee Reports & Tax Treaties

Internal Revenue Code

Current Code

Subtitle F Procedure and Administration §§6001-7874

Chapter 76 JUDICIAL PROCEEDINGS §§7401-7491

Subchapter B Proceedings by Taxpayers and Third Parties §§7421-7437

§7430 Awarding of costs and certain fees.

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**Internal Revenue Code**

**§ 7430 Awarding of costs and certain fees.**

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**(a) In general.**

In any administrative or court proceeding which is brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, the prevailing party may be awarded a judgment or a settlement for—

- (1) reasonable administrative costs incurred in connection with such administrative proceeding within the Internal Revenue Service, and
- (2) reasonable litigation costs incurred in connection with such court proceeding.

**(b) Limitations.**

**(1) Requirement that administrative remedies be exhausted.**

A judgment for reasonable litigation costs shall not be awarded under subsection (a) in any court proceeding unless the court determines that the prevailing party has exhausted the administrative remedies available to such party within the Internal Revenue Service. Any failure to agree to an extension of the time for the assessment of any tax shall not be taken into account for purposes of determining whether the prevailing party meets the requirements of the preceding sentence.

**(2) Only costs allocable to the United States.**

An award under subsection (a) shall be made only for reasonable litigation and administrative costs which are allocable to the United States and not to any other party.

**(3) Costs denied where party prevailing protracts proceedings.**

No award for reasonable litigation and administrative costs may be made under subsection (a) with respect to any portion of the administrative or court proceeding during which the prevailing party has unreasonably protracted such proceeding.

**(4) Period for applying to IRS for administrative costs.**

An award may be made under subsection (a) by the Internal Revenue Service for reasonable administrative costs only if the prevailing party files an application with the Internal Revenue Service for such costs before the 91st day after the date on which the final decision of the Internal Revenue Service as to the determination of the tax, interest, or penalty is mailed to such party.

**(c) Definitions.**

For purposes of this section —

**(1) Reasonable litigation costs.**

The term “reasonable litigation costs” includes—

(A) reasonable court costs, and

(B) based upon prevailing market rates for the kind or quality of services furnished—

(i) the reasonable expenses of expert witnesses in connection with a court proceeding, except that no expert witness shall be compensated at a rate in excess of the highest rate of compensation for expert witnesses paid by the United States,

(ii) the reasonable cost of any study, analysis, engineering report, test, or project which is found by the court to be necessary for the preparation of the party’s case, and

(iii) reasonable fees paid or incurred for the services of attorneys in connection with the court proceeding, except that such fees shall not be in excess of \$125 per hour unless the court determines that a special factor, such as the limited availability of qualified attorneys for such proceeding, the difficulty of the issues presented in the case, or the local availability of tax expertise, justifies a higher rate.

In the case of any calendar year beginning after 1996, the dollar amount referred to in clause (iii) shall be increased by an amount equal to such dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) for such calendar year, by substituting “calendar year 1995” for “calendar year 1992” in subparagraph (B) thereof . If any dollar

amount after being increased under the preceding sentence is not a multiple of \$10, such dollar amount shall be rounded to the nearest multiple of \$10.

**(2) Reasonable administrative costs.**

The term “reasonable administrative costs” means—

(A) any administrative fees or similar charges imposed by the Internal Revenue Service, and

(B) expenses, costs, and fees described in paragraph (1)(B), except that any determination made by the court under clause (ii) or (iii) thereof shall be made by the Internal Revenue Service in cases where the determination under paragraph (4)(C) of the awarding of reasonable administrative costs is made by the Internal Revenue Service.

Such term shall only include costs incurred on or after whichever of the following is the earliest: (i) the date of the receipt by the taxpayer of the notice of the decision of the Internal Revenue Service Office of Appeals; (ii) the date of the notice of deficiency; or (iii) the date on which the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent.

**(3) Attorneys' fees.**

(A) In general. For purposes of paragraphs (1) and (2), fees for the services of an individual (whether or not an attorney) who is authorized to practice before the Tax Court or before the Internal Revenue Service shall be treated as fees for the services of an attorney.

(B) Pro bono services. The court may award reasonable attorneys' fees under subsection (a) in excess of the attorneys' fees paid or incurred if such fees are less than the reasonable attorneys' fees because an individual is representing the prevailing party for no fee or for a fee which (taking into account all the facts and circumstances) is no more than a nominal fee. This subparagraph shall apply only if such award is paid to such individual or such individual's employer.

**(4) Prevailing party.**

(A) In general. The term “prevailing party” means any party in any proceeding to which subsection (a) applies (other than the United States or any creditor of the taxpayer involved)—

(i) which—

(I) has substantially prevailed with respect to the amount in controversy, or

(II) has substantially prevailed with respect to the most significant issue or set of issues presented, and

(ii) which meets the requirements of the 1st sentence of section 2412(d)(1)(B) of title 28, United States Code (as in effect on October 22, 1986) except to the extent differing procedures are established by rule of court and meets the requirements of section 2412(d)(2)(B) of such title 28 (as so in effect).

(B) Exception if United States establishes that its position was substantially justified.

(i) General rule. A party shall not be treated as the prevailing party in a proceeding to which subsection (a) applies if the United States establishes that the position of the United States in the proceeding was substantially justified.

(ii) Presumption of no justification if Internal Revenue Service did not follow certain published guidance. For purposes of clause (i), the position of the United States shall be presumed not to be substantially justified if the Internal Revenue Service did not follow its applicable published guidance in the administrative proceeding. Such presumption may be rebutted.

(iii) Effect of losing on substantially similar issues. In determining for purposes of clause (i) whether the position of the United States was substantially justified, the court shall take into account whether the United States has lost in courts of appeal for other circuits on substantially similar issues.

(iv) Applicable published guidance. For purposes of clause (ii), the term “applicable published guidance” means—

(I) regulations, revenue rulings, revenue procedures, information releases, notices, and announcements, and

(II) any of the following which are issued to the taxpayer: private letter rulings, technical advice memoranda, and determination letters.

(C) Determination as to prevailing party. Any determination under this paragraph as to whether a party is a prevailing party shall be made by agreement of the parties or—

(i) in the case where the final determination with respect to the tax, interest, or penalty is made at the administrative level, by the Internal Revenue Service, or

(ii) in the case where such final determination is made by a court, the court.

(D) Special rules for applying net worth requirement. In applying the requirements of section 2412(d)(2)(B) of title 28, United States Code, for purposes of subparagraph (A)(ii) of this paragraph —

(i) the net worth limitation in clause (i) of such section shall apply to—

(I) an estate but shall be determined as of the date of the decedent's death, and

(II) a trust but shall be determined as of the last day of the taxable year involved in the proceeding, and

(ii) individuals filing a joint return shall be treated as separate individuals for purposes of clause (i) of such section.

(E) Special rules where judgment less than taxpayer's offer.

(i) In general. A party to a court proceeding meeting the requirements of subparagraph (A)(ii) shall be treated as the prevailing party if the liability of the taxpayer pursuant to the judgment in the proceeding (determined without regard to interest) is equal to or less than the liability of the taxpayer which would have been so determined if the United States had accepted a qualified offer of the party under subsection (g).

(ii) Exceptions. This subparagraph shall not apply to—

(I) any judgment issued pursuant to a settlement; or

(II) any proceeding in which the amount of tax liability is not in issue, including any declaratory judgment proceeding, any proceeding to enforce or quash any summons issued pursuant to this title, and any action to restrain disclosure under section 6110(f).

(iii) Special rules. If this subparagraph applies to any court proceeding—

(I) the determination under clause (i) shall be made by reference to the last qualified offer made with respect to the tax liability at issue in the proceeding; and

(II) reasonable administrative and litigation costs shall only include costs incurred on and after the date of such offer.

(iv) Coordination. This subparagraph shall not apply to a party which is a prevailing party under any other provision of this paragraph .

**(5) Administrative proceedings.**

The term “administrative proceeding” means any procedure or other action before the Internal Revenue Service.

**(6) Court proceedings.**

The term “court proceeding” means any civil action brought in a court of the United States (including the Tax Court and the United States Claims Court [United States Court of Federal Claims, see §902(b), P.L. 102-572 ]).

**(7) Position of United States.**

The term “position of the United States” means—

(A) the position taken by the United States in a judicial proceeding to which subsection (a) applies, and

(B) the position taken in an administrative proceeding to which subsection (a) applies as of the earlier of—

(i) the date of the receipt by the taxpayer of the notice of the decision of the Internal Revenue Service Office of Appeals, or

(ii) the date of the notice of deficiency.

**(d) Special rules for payment of costs.**

**(1) Reasonable administrative costs.**

An award for reasonable administrative costs shall be payable out of funds appropriated under section 1304 of title 31, United States Code .

**(2) Reasonable litigation costs.**

An award for reasonable litigation costs shall be payable in the case of the Tax Court in the same manner as such an award by a district court.

**(e) Multiple actions.**

For purposes of this section , in the case of —

- (1) multiple actions which could have been joined or consolidated, or
- (2) a case or cases involving a return or returns of the same taxpayer (including joint returns of married individuals) which could have been joined in a single court proceeding in the same court,

such actions or cases shall be treated as 1 court proceeding regardless of whether such joinder or consolidation actually occurs, unless the court in which such action is brought determines, in its discretion, that it would be inappropriate to treat such actions or cases as joined or consolidated.

**(f) Right of appeal.**

**(1) Court proceedings.**

An order granting or denying (in whole or in part) an award for reasonable litigation or administrative costs under subsection (a) in a court proceeding, may be incorporated as a part of the decision or judgment in the court proceeding and shall be subject to appeal in the same manner as the decision or judgment.

**(2) Administrative proceedings.**

A decision granting or denying (in whole or in part) an award for reasonable administrative costs under subsection (a) by the Internal Revenue Service shall be subject to the filing of a petition for review with the Tax Court under rules similar to the rules under section 7463 (without regard to the amount in dispute). If the Secretary sends by certified or registered mail a notice of such decision to the petitioner, no proceeding in the Tax Court may be initiated under this paragraph unless such petition is filed before the 91st day after the date of such mailing.

**(3) Appeal of Tax Court decision.**

An order of the Tax Court disposing of a petition under paragraph (2) shall be reviewable in the same manner as a decision of the Tax Court, but only with respect to the matters determined in such order.

**(g) Qualified offer.**

For purposes of subsection (c)(4) —

**(1) In general.**

The term “qualified offer” means a written offer which—

- (A) is made by the taxpayer to the United States during the qualified offer period;
- (B) specifies the offered amount of the taxpayer's liability (determined without regard to interest);

(C) is designated at the time it is made as a qualified offer for purposes of this section ; and

(D) remains open during the period beginning on the date it is made and ending on the earliest of the date the offer is rejected, the date the trial begins, or the 90th day after the date the offer is made.

**(2) Qualified offer period.**

For purposes of this subsection , the term “qualified offer period” means the period—

(A) beginning on the date on which the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent, and

(B) ending on the date which is 30 days before the date the case is first set for trial.

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