Hawaii Changes Offer In Compromise Requirements

Hawaii Lowers Deposit Requirements For Lump Sum Offers; Increases Requirements For 'Periodic Payment' Offers; Deposits For Rejected Offers No Longer Refunded; New Law Retains Prior Requirement For Approval of Compromises Exceeding $50,000 In Tax

By Richard Paul McClellan III April 12, 2013

On April 5, 2013, Hawaii Governor Neil Abercrombie signed House Bill 425 into law as Act 6 of 2013. Act 6 significantly changes Hawaii's Offer In Compromise ("OIC") law for OICs based on doubt as to collectability. Act 6 is effective for OICs submitted after April 5, 2013.

Background

Hawaii Revised Statutes Section Section 231-3(10) authorizes the Department of Taxation to compromise tax. 'Compromise' in this context means to reduce or waive the requirement to pay past-due taxes along with penalties and interest.

Subsection (10) expressly requires the approval of the Governor when the amount of tax (excluding penalty and interest) exceeds $50,000; for amounts of tax under $50,000, the Director may compromise the tax without the Governor's approval.

Under current law and unchanged by Act 6, accepted OICs are required to be posted on the Department of Taxation's Website. To see if there are any currently posted OICs, you can look here.

[It should be emphasized that given Hawaii's penalty structure and interest rates, the total bill could be well over $100,000 without the tax portion exceeding $50,000.]

New Law

Act 6 of 2013 adds a new section to Chapter 231. The new section has content addressing "collectability" OICs; in other words, where the taxpayer is unable to pay and the Department is unlikely to collect through enforced collection within a reasonable period.

The new section requires:

- Lump sum OICs (5 or fewer payments) to be accompanied by 20% of the total offer amount;

- Periodic payment OICs (6 or more payments) to be accompanied by the first installment payment, and the Taxpayer must continue to make all scheduled payments while the Offer is pending, or have the Department consider the OIC as withdrawn.

See, Act 6, Section (a).

In addition, rejected offers will <u>not</u> have payments returned. Act 6, Section (b).

The Department can waive the Section (a) payment requirements for individual taxpayers who meet IRS low income guidelines. Section (c).

Legislative History And Existing Administrative Rules

The Department of Taxation "strongly supported" this measure because, according to the Department, it would lead to "conformance with the IRS rules and regulations" and "reduce the number of frivolous OIC applications filed." Conformance with the IRS rules was represented as providing clear guidance for the Department and "taxpayers do not have to be concerned with differing procedures for federal and state purposes." The Department did not explain why it sought to have the law changed, as opposed to modifying its administrative rules.

Under existing administrative rules, OICs had to be accompanied "with a remittance representing the amount of the compromise offer, or a substantial deposit, if the offer provides for installment payments." HAR 18-231-3-10(d)(1). Payments for rejected OICs were returned to the taxpayer without interest. HAR 18-231-3-10(g). As noted above, Act 6 changes the law and these regulations are no longer applicable to OICs.

Comment

Hawaii practice has moved closer to the federal procedure with some potentially significant differences. As noted above, Act 6 did not change the requirement for the Governor to personally approve any compromise with more than $50,000 in tax. For administrative and political reasons, this requirement may be a barrier for taxpayers in getting offers approved. The IRS has no such limitations: for example, the President does not have to approve OICs above a certain dollar threshold.

Second, Hawaii will no longer allow the return of an offered amount. As a result, third parties such as relatives may no longer be willing to "front" money for an OIC, because if the liability is not compromised, they will not get their money back. For example, a relative might be willing to pay the Department $10,000 to have Junior released from his $25,000 tax debt, but only if Junior is released. Under prior law, the relative could make the $10,000 OIC amount. Under the new law, the relative will have to consider that if the OIC is rejected by the Department, the money will not be returned and will be applied to Junior's tax debts (although not necessarily the debt that is the subject of the OIC.)

The Department did not state how long it was taking to process Offers. Under the new law, all periodic payments must be made while the OIC is pending. If a proposal that contemplates $250 a month for 24 months is submitted, the taxpayer may have tendered all 24 payments before knowing whether the OIC is accepted. The term "periodic payments" is not defined in the law, other than being more than six payments. Does "periodic" suggest even or regular intervals? Or could the six payments be irregularly spread over three years? The dictionary suggests that "periodic" could mean regularly or could mean intermittently. Whether Hawaii will adopt a form similar to IRS Form 656 (allowing the payment dates to be specified) is not known.

"Low income taxpayer" may be more expansive than it initially appears. As of the writing of this article, the IRS considers gross income of approximately $2675 per month for an individual to be "low income."

Taxpayers (and their funding sources) should carefully consider Act 6 of 2013 and applicable Administrative Rules (and any changes thereto) before submitting an Offer In Compromise. An Offer does not prevent collection by the Department, but it serves to toll (that is, to extend) the statute of limitations on collection.

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