The Tax Collection Statute of Limitations in Hawai'i

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Introduction

In 2009, Hawai'i enacted a prospective fifteen-year civil statute of limitations for collection for most assessed tax obligations by way of Act 166, Sections 6 through 14, signed into law on July 1, 2009, by then-Governor Linda Lingle.[1]

Tax provisions affected were Net Income Tax, General Excise Tax, Transient Accommodations Tax, Use Tax, Fuel Tax, Conveyance Tax, Rental Motor Vehicle and Tour Vehicle Surcharge, Nursing Facility Tax, and Insurance Premium Tax.

Once these taxes are assessed or "levied," the State Department of Taxation has fifteen years to collect through a levy or to bring a court action to reduce the tax debt to a judgment. Otherwise, the obligation will expire and become legally unenforceable.

This article presents the legislative history and major provisions relating to the collection statute of limitations. Included for practitioners is an outline of relevant strategies and considerations for clients possibly eligible for relief. Finally, I offer some thoughts on how the Department of Taxation might alter its policies and procedures.

Relevant Provisions of Act 166

At forty-nine pages in length, Act 166 added a number of provisions to Hawaii's Tax Code including special provisions and penalties for tax shelter promoters, return preparers, and for returns with "substantial omissions." The collection statute of limitations is a relatively minor portion of this legislation.

Act 166 enacted a collections limitation provision into ten different substantive tax chapters. The basic statutory outline is common

[1] http://www.capitol.hawaii.gov/session2009/bills/GM784_.PDF

(but not identical) to the text from the General Excise Tax, HRS § 237-40, excerpted in part:

§237-40 Limitation period. (a) General rule. The amount of excise taxes imposed by this chapter shall be assessed or levied within three years after the annual return was filed, or within three years of the due date prescribed for the filing of the return, whichever is later, and no proceeding in court without assessment for the collection of any of the taxes shall be begun after the expiration of the period. Where the assessment of the tax imposed by this chapter has been made within the period of limitation applicable thereto, the tax may be collected by levy or by a proceeding in court under chapter 231; provided that the levy is made or the proceeding was begun within fifteen years after the assessment of the tax. For any tax that has been assessed prior to July 1, 2009, the levy or proceeding shall be barred after June 30, 2024.

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:

(1) The taxpayer agrees to suspend the period;

(2) The assets of the taxpayer are in control or custody of a court in any proceeding before any court of the United States or any state, and for six months thereafter;

(3) An offer in compromise under section 231-3(10) is pending; and

(4) During which the taxpayer is outside the State if the period of absence is for a continuous period of at least six months; provided that if 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, the period shall not expire before the expiration of the six months.

(b) Exceptions. In the case of a false or fraudulent return with intent to evade tax, or of a failure to file the annual return, the tax may be assessed or levied at any time; provided that the burden of proof with respect to the issues of falsity or fraud and intent to evade tax shall be upon the State.

Legislative History of Act 166: House Bill 1739[2]

Act 166 did not have a straightforward progression through legislative hearings. The tax collection limitations and tolling periods of Act 166 *first appear at* the Conference Committee stage of proceedings, that is, the end-stage of the legislative process when the House and Senate reconcile differing versions into a conference draft to be voted upon by the full chambers of the House and Senate.

House Bill 1739: Limitations Provisions Added By Conference Committee

House Bill 1739 ("HB 1739") ultimately became Act 166 of 2009. HB 1739 was amended several times to add a number of substantive tax provisions, including penalties for return preparers and fraudulent returns. The limitations provisions were added at the reconciliation stage, despite not being contained in prior versions.

In other words, the legislative record does not reflect that formal hearings were held or testimony received on the collection statute of limitations or tolling periods of HB 1739.

Another bill, Senate Bill 118, was the original "statute of limitations" bill and some of the language from SB 118 SD 1 was apparently inserted into HB 1739 at the conference committee stage.[3]

To underline this point, the State Department of Taxation and the Tax Foundation of Hawaii submitted comprehensive written testimony in late March 2009, on then-HB 1739 (and almost the same testimony on SB 973); the testimony does not contain any

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[2] http://www.capitol.hawaii.gov/Archives/measure_indiv_Archives.aspx?billtype=HB&billnumber=1739&year=2009

[3] HB 55, introduced by Representative Isaac Choy, also contained a ten-year statute of limitations provision. Representative Choy has a background as a CPA and former Chairman of The Tax Review Commission (2005-2007). HB 55 was never scheduled for a hearing.

discussion of a civil collection after assessment statute of limitations.[4] Similarly, the HB 1739 Senate Draft 1 inserted language from SB 973 SD 1 but that language did not contain collection statute of limitations provisions.

The earliest mention of a collection after assessment statute of limitations can be found in Conference Committee Report No. 5 by Senator Donna Mercado Kim and Representative Marcus R. Oshiro, dated April 23, 2009.[5] Conference Committee Report No. 5 states that the purpose of Act 166 is to "deter tax fraud and promote uniformity in the state tax system." (page 1)

Later, the Conference Committee Report states, in pertinent part:

> Your Committee on Conference has amended this bill by:
>
> (1) Allowing the following taxes to be collected by levy or by a proceeding in court within 15 years after the assessment of the tax if the assessment of the tax was imposed within the three-year period of limitation established by law;
>
> [*material omitted*]
>
> (2) Requiring that the limitation on collection after the assessment of the aforementioned taxes be suspended for certain periods;

Conference Committee Report No. 5, pp. 2-3.

[4] http://www.capitol.hawaii.gov/session2009/Testimony/HB1739_TESTIMONY_WAM_03-24-09.pdf

[5] http://www.capitol.hawaii.gov/session2009/CommReports/HB1739_CD1_CCR5_.HTM

Senate Bill 118: The "Original" State of Limitations Bill

Senate Bill 118[6] was introduced by Senator Brian T. Taniguchi. SB 188 proposed a ten-year statute of limitations with only two tolling provisions, the bankruptcy and "outside the State" provisions.[7] SB 118 started the limitations period from the filing of an "annual, semiannual, quarterly, or monthly return…whichever is earlier."

The Department of Taxation opposed SB 118. The Department's general position was that an "unlimited" statute of limitations on collection was a "material benefit" to the general fund in a time of "fiscal crisis." The Department estimated a revenue loss of "at least $10 million per year." The Department's testimony stated that a statute of limitations would force the Department to "pursue more foreclosures and seizures." See, Testimony of February 10, 2009, Department of Taxation.[8]

The Department was also strongly opposed to permitting any statute of limitations to commence with a periodic filing, and asserted that periodic returns existed "simply to ensure a consistent revenue stream into the treasury." The Department requested the following in the interest of "fairness":

(1) that various penalty provisions be enacted to make up the revenue loss;
(2) that the statute of limitations be "phased in" starting with a 20 year limitations period, then declining to15 years, then to 10 years;
(3) that the statute must toll (be extended) similar to IRC section 6502.

See, Department Of Taxation's Testimony. Finally, the Department requested in its testimony that specific language be added to the bill. The Senate Committee apparently revised that language and

[6] http://www.capitol.hawaii.gov/Archives/measure_indiv_Archives.aspx?billtype=SB&billnumber=118&year=2009

[7] http://www.capitol.hawaii.gov/session2009/Bills/SB118_.HTM

[8] http://www.capitol.hawaii.gov/session2009/Testimony/SB118_TESTIMONY_JGO_02-10-09.pdf

the general provision appeared in SB 118 Senate Draft 1 as the tolling period for bankruptcy and being "outside the state."[9]

Testimony by other groups and individuals tended to support the measure on that basis that it put Hawai'i law in conformity with federal law, promoted fairness to taxpayers, and prevented problems related to very old tax bills.

Ultimately, the Senate Committee referred SB 118 out as Senate Draft 1 on February 19, 2009, having incorporated the Department of Taxation's proposed changes (with minor revisions) with the following exceptions:

(1) the ten-year statute was left unchanged;
(2) no provision was made for tolling by agreement or due to an offer in compromise being made.

SB 118 SD 1 passed "second reading" but never received another hearing.

The legislative history of HB 1739 reflects a tortured process and in some potentially important areas did not provide guidance for the Department of Taxation, Courts, citizens, and practitioners.

[9] http://www.capitol.hawaii.gov/session2009/bills/SB118_SD1_.pdf

Major Provision: Not Retroactive

The limitations period of Act 166 was not retroactive. The earliest date that liabilities assessed prior to July 1, 2009, will expire, barring tolling events, is June 30, 2024. Taxes assessed after July 1, 2009, barring tolling events, will expire fifteen years from the date of assessment.

Major Provision: Annual Return For Assessment

The limitations period only applies to taxes that are "assessed" or "levied." Taxes are typically assessed by the filing of a return by a taxpayer. A thorough discussion of the methods of assessment or levy is beyond the scope of this article.

It is not uncommon for assessment to occur years after the return was originally due as a result of late filing (particularly of the General Excise G-49 Annual Return) or an audit by the State or the Internal Revenue Service.

In the instance of a "false or fraudulent return with intent to evade tax," the Department may assess or levy the tax "at any time." See, for example, HRS § 237-40(b). Notably, the burden of proof to establish falsity and the intention to evade is upon the State. This means that the Department of Taxation can re-open any assessment if it can establish a "false and fraudulent return" with the "intent to evade" and thereby trigger a new collection period altogether or at least a new period for the additional assessment.

An *annual* return is required to trigger an "assessment." See, for example, HRS § 235-111(a) ["…within three years after filing of the return for the taxable year…"]; HRS § 237-40(a), § 237-40(b), ["annual return" in context of General Excise Tax.] Periodic returns, meaning monthly, quarterly, or semi-annual returns, do not trigger an "assessment" that starts the collections limitations period.

Major Provision: Levy Or Court Action

The Department of Taxation can issue a levy prior to the expiration of the statute of limitations period and the levy will survive the expiration of the limitations period.

The expiration of the statutory limitations period can also be avoided if the Department brings a formal legal ("court") action to reduce the tax lien to a judgment. A civil action resulting in a judgment would be subject to a new statute of limitations for judgments.

Major Provision: Tolling Events

There are a number of actions or occurrences that can extend or "toll" the fifteen year limitations period.

(1) For the period that the taxpayer agrees to suspend the period;

(2) For the period that the taxpayer's assets are in control or custody of a court in any proceeding before any court of the United States or any State, plus six months thereafter;

(3) For the period that an "offer in compromise" pursuant to HRS § 231-3(10) is pending;

(4) During which the taxpayer is outside the state if the period of absence is for a continuous period of at least six months; provided that if 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, the period shall not expire before the expiration of the six months. Discussion of the tolling events, in particular the "outside the state" provision, can be found below.

Analysis

Practitioners Should Carefully Evaluate The Date Of Assessment.

Practitioners should carefully determine the date(s) of assessment or levy. In the situation of regular, timely filed returns, with prompt billing notices and perhaps a tax lien filing, this should be straightforward. Without an assessment, the limitations period will not start.

In situations without the bright-line of a regularly filed annual return, practitioners should try to gather as much documentary support for the assessment date as possible for obvious reasons. Hawaii's courts have been reluctant to accept the taxpayer's unsupported memory when contradicted by the Department of Taxation's records (or, more precisely, the absence of a record).[10]

The HB 1739 Conference Committee makes a curious reference (quoted above) to the limitations period applying to taxes assessed during the three year limitation period. The text of Act 166 does not reflect an intention to restrict the benefit of the limitations period to returns assessed within three years of the original filing due date: this statement appears to be an expression of an intention towards an earlier version of the bill or just irrelevant.

False & Fraudulent Returns Could Restart the "Assessment or Levy" Date.

The State can assess or levy for a false or fraudulent return, with intent to evade tax, at any time. The State bears the burden of proof. This means that, in theory, any assessment could be revised if the State had the ability to prove falsity with an intention to evade.

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[10] See, HRS § 231-8(a)(2); In the Matter of the Tax Appeal of Bobby R. Narmore, T. A. No. 02-0065, Tax Appeal Court, State of Hawaii [Tax Appeals Court found taxpayer did not sustain burden of proof as to timely mailing of general excise tax return when relying solely upon his memory and without mailing receipts or other evidence.]

As a practical matter, however, after substantial time has passed from the date of original assessment or levy, the State is unlikely to have the administrative impetus and to possess the requisite evidence to re-start matters.

The statute does not exclude periods where the taxpayer has fraudulently concealed assets from the period of limitations, absent a false or fraudulent return. While 'evasion of payment' maybe a crime pursuant to HRS § 231-34, evasion of payment apparently does not toll the collection limitations period unless accomplished through a false and fraudulent tax return.

Tolling Events

I have summarized the tolling provisions above. There is no substitute for your own reading.

Several of the tolling procedures should appear familiar to legal professionals and are common provisions of tax or civil limitations clauses.

Agreement To Extend

Subparagraph (1), making an agreement to extend the limitations period, appears in federal law and most practitioners will be familiar with its use in tax audits. See, 26 U.S.C. § 6501(c)(4)(A).

Control Or Custody Of A Court

Subparagraph (2), tolling those periods when the Department cannot reach the taxpayer's assets, such as during bankruptcy, receiverships or related legal proceedings, etc., plus six months, is also borrowed from federal law. See, 26 U.S.C. § 6503(b).

State Offer In Compromise

Similar to the federal provision, subparagraph (3), an offer in compromise, tolls the period. The rationale may be that the delay in collection proceedings typically caused by such an offer should not benefit the delinquent taxpayer.

Periods "Outside the State" For At Least Six Months Are Excluded.

Sub-paragraph (4) states:

> During which the taxpayer is outside the state if the period of absence is for a continuous period of at least six months; provided that if 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, the period shall not expire before the expiration of the six months.

Compare this to 26 U.S.C. § 6503(c):

> **(c) Taxpayer outside United States**
> The running of the period of limitations on collection after assessment prescribed in section 6502 shall be suspended for the period during which the taxpayer is outside the United States if such period of absence is for a continuous period of at least 6 months. If the preceding sentence applies and at the time of the taxpayer's return to the United States the period of limitations on collection after assessment prescribed in section 6502 would expire before the expiration of 6 months from the date of his return, such period shall not expire before the expiration of such 6 months.

See, 26 USC § 6503(c)[11]. The Department of Taxation specifically asked for this language in a hearing on SB 118 on February 10,

[11] http://www.law.cornell.edu/uscode/text/26/6503

2009, before the Senate Committee for the Judiciary and Government Operations.[12]

This "outside the State" language may prove problematic for individual taxpayers and practitioners seeking to benefit from the statute. Hawai'i is a state with a substantial transient population and many Hawai'i taxpayers maintain business and personal ties with other states, territories and countries including China, the Federated States of Micronesia, Guam, Japan, South Korea, Mexico, Samoa, Thailand, and Viet Nam. Practitioners will seek to include as many delinquent taxpayers as possible within the protections of Act 166, and a narrow interpretation of Act 166's "outside the State" language will be of the greatest benefit. Therefore I have provided some initial thoughts on how the "outside the State" language might be interpreted.

Interpretation of 26 U.S.C. 6503(c) And The Federal Approach

According to a reported decision, Congress amended section 6503(c) [to the language cited above] to avoid problems with a prior approach based upon the taxpayer's assets' location in favor of an approach based on the taxpayer's location.

Prior Approach	Current Approach
Location of Taxpayer's Assets	Location of Taxpayer

Congress decided that short periods of absence were too difficult to keep track of administratively, and adopted the bright-line test of "continuously" out of the country for at least six months. See, United States v. Nesline, 590 F.Supp 884, 890 (D.C. Md. 1984). The District Court in Nesline rejected the Internal Revenue Service's effort to rely upon its Regulations as contrary to the plain language of 6503(c) and Congressional intent based upon committee reports. The IRS Regulations employed a "generally and substantially absent" test and specifically stated that "casual temporary visits"

[12] See, at page 3 of 10: http://www.capitol.hawaii.gov/session2009/Testimony/SB118_TESTIMONY_JGO_02-10-09.pdf

were inadequate to break a “continuous” absence. See, 590 F.Supp at 886. [Curiously, the IRS has kept 26 C.F.R. § 301.6503(c)-1(b) unchanged from the Nesline decision.[13]]

The Court in Nesline accordingly rejected the IRS’ motion for summary judgment. 590 F.Supp. at 891.

The federal approach is a bright-line standard based upon the physical location of the taxpayer. For instance, the Internal Revenue Manual (used by IRS Revenue Officers) generally paraphrases section 6503(c).

A Hawaii court might ultimately adopt the federal approach as reflected in the Congressional history, the Internal Revenue Manual, and explained by the Nesline court.

In such an instance, the tolling provision would simply be governed by the physical location of the tax debtor. Transient contacts such as a four-day vacation visit would be sufficient to prevent a “continuous” absence or re-start a six month period.

Hawai’i Courts Might Not Adopt The Federal “Physical Presence” Interpretation

The federal approach simply looks at the physical presence of a taxpayer. This could create some strained results at the State level.

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[13] 26 C.F.R. § 301.6503(c)-1 (b) *Taxpayer outside United States after November 2, 1966.* The running of the period of limitations on collection after assessment prescribed in section 6502 (relating to collection after assessment) is suspended for the period after November 2, 1966, during which the taxpayer is absent from the United States if such period is a continuous period of absence from the United States extending for 6 months or more. In a case where the running of the period of limitations has been suspended under the first sentence of this paragraph and at the time of the taxpayer's return to the United States the period of limitations would expire before the expiration of 6 months from the date of his return, the period of limitations shall not expire until after 6 months from the date of the taxpayer's return. *The taxpayer will be deemed to be absent from the United States for purposes of this section if he is generally and substantially absent from the United States, even though he makes casual temporary visits during the period.* (emphasis added)

For instance, persons with substantial Hawaii income and assets but without regular visits to the State would not be protected by the statute, while persons that regularly visited but had no economic contacts would be protected.

Practitioners should consider whether Hawaii courts might adopt a different approach, due to various considerations. I have outlined potential approaches and arguments for your consideration.

Modified Federal Approach

A Hawaii Court could interpret the word "taxpayer" to include the assets and property of the taxpayer and then apply the "outside the state" criteria. This would be a rejection of the Congressional intent of Section 6503 in favor of a more nuanced approach. This would arguably be consistent with Hawaii decisions in analogous areas.

Jurisdictional Approach Based on Interpretation of Civil Limitations Periods In Hawai'i

Similar "outside the state" language is found in the civil limitations provision found in HRS § 657-18 "Extension By absence from State."[14]

> §657-18 **Extension by absence from State**. If at any time when any cause of action specified in this part or section 663-3 accrues against any person, the person is out of the State, the action may be commenced within the terms respectively limited, after the return of the person into the State, and if, after the cause of action has accrued, the person departs from and resides out of the State, the time of the person's absence shall not be deemed or taken as any part of the time limited for the commencement of the action.[15]

An initial reading suggests that if a person is physically "out of the State" or "departs and resides out of the State," then the statute of

[14] Reference can also be made to 26 U.S.C. 6531 ("Periods of Limitation On Criminal Prosecution.")

[15] http://www.capitol.hawaii.gov/hrscurrent/Vol13_Ch0601-0676/HRS0657/HRS_0657-0018.htm

limitations is extended for the duration of the absence. Court interpretations, however, have not reached this result.

Hawaii cases (from 1998 and 2000) consider whether a person is subject to jurisdiction in interpreting HRS § 657-18.[16] [17] See, <u>Shin v. McLaughlin</u>, 89 Hawaii 1, 967 P.2d 1059 (1998)[18][interpreting "out of the state" to mean not amenable to service of process or subject to jurisdiction]; <u>First Hawaiian Bank v. Powers</u>, 998 P.2d 55, 93 Hawai'i 174 (2000)[19][Defendant subject to jurisdiction of Hawai'i Courts and amenable to service of process so HRS § 657-18 did not apply]; <u>Eto v. Muranaka</u>, 57 P.3d 413, 99 Haw. 488 (2002)[20] [resident of Japan subject to Hague Convention, statute not tolled.]

From these decisions (<u>Shin</u>, <u>Powers</u>, <u>Eto</u>), a conclusion would be drawn that "out of the State" refers only to persons not amenable to jurisdiction or legal process.

A weakness is this argument is that these decisions, however, are not tax decisions but personal injury and civil cases. Legal considerations have historically been different in tax cases.

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[16] Federal law on similar language in 26 U.S.C. § 6531 interprets "outside" to mean "whenever such persons cannot be served with [criminal] process within the jurisdiction…" <u>United States v. Marchant</u>, 774 F.2d 888, 891-892 (8th Cir. 1985), cert. denied 475 U.S. 1012 (1986).

[17] http://scholar.google.com/scholar_case?case=11713975106771090873&q=United+States+v.+Marchant&hl=en&as_sdt=2,5&as_vis=1

[18] http://scholar.google.com/scholar_case?case=12396309691160244402&q=Shin+v.+McLaughlin&hl=en&as_sdt=2,5&as_vis=1

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http://scholar.google.com/scholar_case?case=8449555760107659037&hl=en&as_sdt=2,5&as_vis=1&kqfp=16833566796699000971&kql=188&kqpfp=1540826872390566798#kq

[20]

http://scholar.google.com/scholar_case?case=14022122930072702539&hl=en&as_sdt=2,5&as_vis=1&kqfp=7550151014624810781&kql=101&kqpfp=12036159986261143919#kq

Tax judgments have traditionally followed 'The Revenue Rule' exception to comity.[21] [22] In other words, tax judgments are generally not enforceable outside their rendering jurisdiction under the common law.

Only in 1935 did the United States Supreme Court determine that state tax judgments were subject to enforcement pursuant to the Full Faith and Credit Clause of the Constitution.[23] See, Milwaukee County v. M.E. White & Co., 296 U.S. 268, 276-277 (1935)[24] [Wisconsin income tax judgment entitled to enforcement by federal district court in Illinois pursuant to full faith and credit clause.]

While Milwaukee County resolved domestic tax judgments, foreign tax judgments are still not entitled to enforcement, pursuant to The Revenue Rule. See, for example, Her Majesty The Queen, Etc. v. Gilbertson, 433F.Supp. 410 (D. Ore. 1977)[25] [Canadian province not entitled to enforce tax assessment in Oregon based on comity as Canada followed "The Revenue Rule."] In Hawaii, foreign-country tax judgments are specifically not entitled to reciprocal enforcement pursuant to statute. See, HRS § 658F-3(b)(1). This does not mean that a comity argument would not prevail with a Hawai'i court in an appropriate situation.

[21] See, Hilton v. Guyot, 159 U.S. 113 (1895);
http://scholar.google.com/scholar_case?case=16760160524425792858&hl=en&as_sdt=2,5&as_vis=1

[22] For a Hawaii context see, Waxman v. Kealoha, 269 F.Supp. 1190 (D. Haw. 1969)[Hawaii District Court denied Defendants' Motion To Dismiss, finding District Court would recognize Canadian Bankruptcy trustee suing to recover on stock subscription agreements entered into by Hawaii residents.]
http://scholar.google.com/scholar_case?case=3222032585403781433&q=Waxman+v.+Kealoha&hl=en&as_sdt=2,5&as_vis=1

[23] U.S. Constitution, Article IV, Section 1 ("Full faith and credit shall be given in each state to the public acts, records, and judicial proceedings of every other state.")

[24] http://scholar.google.com/scholar_case?q=Milwaukee+County+v.+ME+White&hl=en&as_sdt=2,5&as_vis=1&case=5901183028124997123&scilh=0

[25] http://scholar.google.com/scholar_case?q=Her+Majesty+The+Queen&hl=en&as_sdt=2,5&as_vis=1&case=5567842715157137660&scilh=0

Practitioners should keep in mind that tax assessments are not judgments, but administrative decisions not subject to the same considerations as a judgment. Careful inquiry should be made whether Hawaii has a tax agreement with another jurisdiction that gives legal effect to Hawaii's tax assessment.

If the collection limitations provision sub-paragraph (4) is interpreted in light of the civil statute of limitations and not the federal statute, the conclusion that "outside of the State" means beyond the jurisdictional reach of Hawaii is reasonable. Under the United States Constitution, "outside the state" cannot include any of the States or territories. Only persons in foreign countries are therefore "outside the State."

Finally, any person that is "outside the State" for more than six months will be subject to the State's collection efforts for at least six months from their return:

> 237-40(a) (4) During which the taxpayer is outside the State for a continuous period of at least six months; *provided that if 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, the period shall not expire before the expiration of the six months.*

On one level, the phrase "return to the State" is susceptible to the same interpretation as the "outside the State." If the federal approach is strictly followed, only a physical return to the physical state will suffice. A "federalist" approach would suggest that a physical return to the jurisdiction of the state (which would include all of the states and territories subject to the Full Faith and Credit Clause) would be sufficient. An asset-based approach would suggest that the return of assets to the state would be sufficient to re-start the statute.

The “return” language might or might not toll the statute, because a return with more than six months left on the statute does not extend the period.

Implications From Legislative History

A stated legislative purpose of Act 166 was “fairness” to taxpayers, in this case, delinquent taxpayers. “Fairness” to tax debtors could persuade a Hawai’i court to interpret “outside the state” differently than its federal counterpart, because the national government and the state government have different considerations.

Congress was perhaps justified in limiting federal limitations protection to persons physically present in the United States. Most taxpayers have earned income from employment, and thus those that are physically present are subject to collection efforts. From a state perspective, however, the idea of limiting protection to residents strikes at the core of the idea of the free movement of persons and property between the states, and that all persons are subject to an even-handed enforcement of the laws, without undue protections for in-state residents. For Hawaii, its possible that persons filing and paying income and other taxes on substantial Hawaii-based assets would not be physically present and therefore not benefit from the limitations period.

If an asset-location approach is used, any taxpayer with assets within the United States is subject to the reach of the State Department of Taxation via enforcement agreements between the States and the Full Faith And Credit Clause.

Practical Considerations

The enactment of a limitations period should be of enormous benefit to delinquent taxpayers that fall within its provisions. Practitioners will seek to interpret these provisions as expansively as possible.

Comment on The Fifteen Year Length

The fifteen year limitations period starts upon assessment or "levy," which in many cases will be months or years after the return was originally due.

Fifteen years is five years longer than the federal tax collections limitations period. Fifteen years is also a considerable period in the scope of life and is probably too long to be realistically considered in most tax planning. In other words, fifteen years is too long to attempt to "wait out" the Department on tax debt if any alternative is available. As of the writing of this article, the earliest "expiration date" (June 30, 2024) is more than twelve years away. As the first expiration period becomes closer, the limitations period may offer hope to many delinquent taxpayers and provide leverage in negotiations with the Department of Taxation.

The Importance of Maintaining Records Of Assessment Cannot Be Overstated.

The new limitations provisions underscore the importance of filing annual returns, preferably on time and with a record of mailing. This is particularly applicable to the General Excise Tax and Withholding Tax. *The limitations period will not run on taxes requiring periodic returns absent an annual return or reconciliation.*

Practitioners are familiar with the Department taking collection enforcement measures on unpaid periodic returns. There is an asymmetry in the Department collecting on filed periodic returns, yet the statute of limitations does not run unless an annual reconciliation is filed.

It is highly unlikely that a Court will overlook the fact that the Legislature removed periodic returns from early legislation and ignored testimony supporting the limitations period running from assessment of periodic returns.

To borrow from general civil procedure, a statute of limitations is an "affirmative defense" and must be proven by the party seeking its benefit. See, for example, Hawaii Rules of Civil Procedure, Rule

8(c). Few people will have accurate records of assessment stretching back fifteen years and enabling them to establish the dates of assessment. This is particularly true for taxes assessed or "levied" in the 1970-2000 time frame, before the implementation of the 'new' Department of Taxation computer system. The Narmore case referenced above underlines the importance of establishing the filing date with competent evidence. In the absence of their own records, taxpayers may have to accept the Department of Taxation's records.

Records of absences for more than six months should also be researched, possibly through examination of current or expired passports. Presumably, the Department of Taxation will bear the burden of proof to establish an exception to the statute of limitations. For U.S. residents residing within the United States, but outside Hawaii, the Department of Taxation will presumably be able to establish the exception through information sharing with the IRS and other states. For example, the IRS uses tax return addresses to determine whether the taxpayer is abroad. See, IRM 5.1.19.3.7.2 (06-04-2009.)

Tolling Periods And Alternative Arguments

As noted above, the tolling periods relating to an agreement, bankruptcy, and offers in compromise appear fairly straightforward and directly comparable to existing federal law.

The "outside the State" exception appears complex. There is no evidence in the legislative record that the Legislature explicitly considered the federal approach.

Despite the congressional history of the Federal Tax Lien Act of 1966 (amending Section 6503(c)), there may be a strong argument that if one has assets within Hawaii should be considered as within the State or at least not "outside the State." For example, an individual who maintains bank accounts in local banks and owns real property (perhaps rental property), but is domiciled in Japan and rarely physically present in Hawaii should not be excluded from the protection of the statute. This person is readily subject to the power of the Department of Taxation to lien and levy, at least to the extent of their ownership of Hawaii property and receipt of Hawaii-based income. The Department has levy powers over such a person similar to that of residents.

Finally, practitioners should determine whether the United States has entered a tax enforcement treaty or other arrangement with the foreign jurisdiction that would render a tax debt by the State of Hawaii enforceable under common law "comity" doctrine. The presence of such an arrangement could bolster an argument based upon jurisdictional reach.

Possible Policy Changes

The Department of Taxation has no institutional experience with a statute of limitations on collection. As the first expiration period is still approximately twelve years away (as of this writing), the Department will probably not change its standards for collection until approximately three to five years prior to 2024. At that point, the Department may begin to seek extensions on payment plans for "old" tax accounts and/or may resort to dramatic collection or judicial actions for tax debts shortly to expire. Readers are reminded that in the Department's written testimony submitted with SB 118, the Department stated that collections efforts would have to be more vigorous with a limitations period in place.

Real property owners should recognize the Department's testimony about abandoning its "wait and see" approach in the face of a statute of limitations might be particularly applicable to them. Real property owners pay down mortgage balances, see price appreciation, and thereby amass equity over time. They are particularly vulnerable to foreclosure on the eve of the statute. Previously, the Department of Taxation could just wait for a property to ultimately be sold – now the Department will have to act within fifteen years or relinquish their claims.

Currently, there is no information available on the criteria the Department of Taxation may use to determine which delinquent accounts will be reduced to judgments.

The provision that Taxpayers may agree to extend the limitations period creates the potential for difficult situations in negotiations. The Department may seek to condition payment plans upon such an agreement.

Non-residents and infrequent visitors should explore alternatives to reliance upon the statute because the interpretation of “outside the State” is too uncertain to rely upon.

Conclusion

Taxpayers relying upon the statute of limitations should strongly consider a review of their matters both to determine the effectiveness of such a strategy and whether they will fall within the ambit of Act 166.

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