

Getting Back Into the System: An Outline of Hawaii's "Voluntary Disclosure" Practice Guidelines

Description And Analysis of Hawaii's Official Guidelines On "Getting Back Into" Hawaii's Tax System If You Have Exposure To Possible Criminal Or Civil Penalties.

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Voluntary Disclosure: What Is It?

"Voluntary Disclosure" is what tax authorities call the set of policies and practices designed to encourage non-compliant taxpayers to re-enter the tax system. These policies and practices provide some assurance as to the treatment of undiscovered civil tax obligations and undeveloped potential criminal culpability for tax crimes. Stated another way, a "voluntary disclosure policy" is a formal description of how a tax authority will treat taxpayers coming forward with liabilities or culpabilities at that point unknown or undiscovered by the tax authority. Typical undiscovered tax misconduct includes unfiled returns and fraudulent returns omitting substantial income or types of income.

Voluntary Disclosure As A Policy: Reasons For And Against

Tax authorities probably do not like the concept of a voluntary disclosure policy for several reasons. It is an admission that the tax authority cannot uncover, on its own, all tax non-compliance. Furthermore, because some non-compliant taxpayers (the undetected ones) will be treated more favorably than other non-compliant taxpayers (the ones the Department audited, assessed or prosecuted), tax authorities may consider such a policy to be "unfair." Another potential problem is that a voluntary disclosure policy raises a prospect that an otherwise attractive target for criminal prosecution will come forward at an ambiguous time and raise the program as a defense to prosecution, possibly successfully. Balanced against these evils, tax authorities know that they cannot possibly catch all non-compliant taxpayers and that a disclosure policy will bring in additional current and potentially future revenue that never would have been obtained otherwise. Given these competing policies, voluntary disclosure measures are frequently written to attempt to give away as little as possible while at the same time retaining as much of the incentive as possible. Hawaii is no different in this regard.

Voluntary Disclosure: Hawaii's Written Guidance

The Hawaii Department of Taxation has made several announcements about its “voluntary disclosure” “practice,” the most formal recent announcement was made in August 2010 through Tax Information Release (“TIR”) 2010-07, found [here](#).

Basically, the Department’s position, as articulated in 2010-07, is that coming forward (“voluntary disclosure”) is *just a factor* in considering criminal prosecution and penalty imposition. The voluntary disclosure practice is stated not to be a right, or even a policy, but merely a set of guidelines regarding a practice.

Voluntary Disclosure: Qualification For Hawaii's Practice

General parameters for a qualifying [TIR 2010-07](#) “voluntary disclosure” require:

- The taxpayer to “beat the Department to the punch” – meaning, to come forward before there is a disqualifying reason to do so. Disqualifying reasons are stated as:
 - A federal or state audit;
 - A federal or state criminal investigation; or
 - The need for a tax clearance.
- The voluntary disclosure does not relate to offshore accounts or investments subject to the Internal Revenue Service’s Offshore Disclosure programs; and,
- The voluntary disclosure must be “truthful, accurate, and complete” and the taxpayer to “fully cooperate” in the assessment of taxes.

Hawaii’s TIR 2010-07 is not limited to certain types of taxes (for example, income only) and does not disqualify taxpayers with:

- unreported income from illegal or quasi-illegal activities;
- tax licenses for the types of taxes at issue;
- prior tax problems; or
- tax debts in other types of taxes.

Procedure

TIR 2010-07 does not require a taxpayer to make a formal application, although a taxpayer shall direct questions regarding eligibility to a specified Coordinator. See, [TIR 2010-07](#). This is in contrast to other disclosure programs, such as the [Offshore Bank Accounts Disclosure](#), which specifically required a written application and the provision of particular information. [As of April 2013, the Offshore Disclosure Program had expired and had not been updated. In informal advice from the Department, no time frame for a revision could be provided.]

The voluntary disclosure TIR requires a taxpayer to submit (file) returns or amended returns, and to “fully cooperate” in determining the tax liability. If you read the TIR closely, you may agree with the assessment that the voluntary disclosure is only “complete” when assessment is finished: meaning, all tax, penalties, and interest assessed. This could well be after returns were filed, or even at the completion of an audit of filed returns.

[TIR 2010-07](#) does not require payment in full upon assessment. Many states are not so lenient. See, [California](#), [New York](#), and [North Carolina](#), for instance.

[TIR 2010-07](#) has a ten-year look-back period. “Look back” means the number of years that the Department will look to see have been filed or corrected. The Department reserves the right ‘on a case-by-case basis’ to go back further. The Department asserts that it will assess penalties and interest on all outstanding periods, but “[will consider waiver of penalties on a case-by-case basis.](#)”

Voluntary Disclosure: Considerations

At the Department of Taxation Summer Workshop in August 2013, Department personnel reviewed the 2010-07 TIR but did not elaborate upon it. Two slides, #43 and #44, were addressed to voluntary disclosure. The slides are attached for reference.

Hawaii’s policy has some positives and can be viewed in certain respects as generous. For example, illegal and quasi-illegal income is not expressly excluded. All tax types are eligible. There is no bar to previously compliant taxpayers participating. (Some states, for example [New Jersey](#), exclude persons with appropriate tax licenses from participating.) Hawaii has no requirement for prompt payment of the assessed balances.

Hawaii’s voluntary disclosure practice may leave persons with some types of tax problems facing difficult decisions. The practice does not provide much comfort in terms of look-back period (could be as long as the activity generated taxes). Experience suggests that the Department is more than likely to go beyond ten years for General Excise and Transient Accommodations Taxes. These taxes are (relatively) easy to calculate, are based upon revenue, and do not require a “profit.”

Hawaii does not offer to waive penalties. Many states waive penalties on a specified basis. Civil penalties on tax balances can be assessed at 25% to 50% (fraud). Hawaii interest is 2/3rds of a percent per month, or 8% annually. Getting the Department to consider a waiver of penalties and/or interest is second in importance only to eliminating the potential for criminal sanctions. The [Voluntary Disclosure TIR](#) provides little comfort on penalty and interest reduction, stating only that “the Department will consider wavier of penalties on a case-by-case basis.”

The practice announced in the TIR is relatively thin on guarantees against criminal tax prosecution, and is not binding upon any other investigatory agency. Assuming the taxpayer genuinely comes forward before a referral to criminal investigation, an investigation may be highly unlikely for practical reasons. If the prosecution of a person who had come forward voluntarily was commenced, and the fact became known among tax practitioners, then voluntarily compliance could come to a virtual halt to the substantial detriment of the Department.

Taxpayers considering a voluntary disclosure have a number of difficult decisions. Changes to existing tax positions, whether filing returns or amending returns, are admissions that the prior situation was not correct. Because various tax filings bear upon other tax and business entries, correcting one situation can focus attention upon other potential deficiencies. Further, an inaccurate or incomplete disclosure could result in a streamlined criminal investigation and prosecution, potentially with additional charges relating to the submission.

Financial exposure may be difficult to calculate due to the ambiguity of the look-back period.

Past due tax obligations can be financially burdensome. Penalties can be substantial and Hawaii's interest rate (2/3rds of a percent per month) is virtually a penalty when compared to commercially prevailing and Treasury rates over the past 15 years. Seeking relief from penalties and potentially interest is important.

Persons considering a voluntary disclosure of unfiled or erroneous tax returns should consult with appropriate tax professionals to meaningfully evaluate their situation. This article is only intended as an overview and should not be considered or relied upon as legal advice.

Voluntary Disclosure

- ▶ A voluntary disclosure allows taxpayers to come forward and disclose erroneous, fraudulent, or potentially criminal tax related behavior.
- ▶ Upon disclosure, the Department considers such voluntary compliance as a factor in whether to criminally investigate or refer such taxpayer for criminal prosecution.
- ▶ A voluntary disclosure will be considered as such when a taxpayer fully cooperates with the Department in determining the taxpayer's tax liability.

▶ 43

Voluntary Disclosure

- ▶ The disclosure must be timely, meaning that the person is entitled to make a voluntary disclosure because such person is not under audit or criminal investigation.
- ▶ All communication relating to the voluntary disclosure must also be truthful, accurate and complete.
- ▶ Taxpayers may not argue that other taxpayers similarly situated were not criminally investigated or referred for prosecution.

▶ 44