



GETTING BACK INTO THE SYSTEM BEFORE THE TAX SYSTEM GETS YOU: AN OUTLINE OF HAWAII'S "VOLUNTARY DISCLOSURE" PRACTICE GUIDELINES

Includes Analysis of Tax Information Release 2016-02

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June 24, 2016

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," with formal releases in August 2010, via Tax Information Release ("TIR") 2010-07, and most recently in May 2016, via TIR 2016-02, [here](#).

Basically, the Department’s position, as articulated in 2010-07 and 2016-02, 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

General parameters for a qualifying “voluntary disclosure”:

- The taxpayer to “beat the Department to the punch” – meaning, to come forward on a non-anonymous basis before there is a disqualifying reason to do so. Disqualifying reasons are stated as:
 - Presence of a federal or state audit;
 - Presence of a federal or state criminal investigation;
 - A prior contact by the Department; and,
 - A prior disclosure within five years;
- The voluntary disclosure must be “truthful, accurate, and complete” and the taxpayer to “fully cooperate” in the assessment of taxes.

Hawaii’s voluntary disclosure 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.

Process

TIR 2016-02 has displaced the informal approach of TIR 2010-07.

TIR 2016-02 requires a detailed written request with very specific contents, *including an affidavit*, that includes, among other things:

- a full description of all real and personal property;
- the date activities started in Hawaii and the nature of activities;
- the reason for noncompliance with Hawaii tax law, and how noncompliance was discovered;
- the reasons for coming forward, including whether a tax clearance certificate is being sought.

The written submission must be forwarded to a specific contact email provided in TIR 2016-02.

TIR 2016-02 does not require payment in full upon assessment. Many states are not so lenient. See, [California](#), [New York](#), and [North Carolina](#), for instance.

TIR 2016-02 continues the practice of a ten-year look-back period, with the same limitations as TIR 2010-07. “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. “Questionable conduct or business practices” are “reasons” the Department may look back further.

The Department asserts that it will assess penalties and interest on all outstanding periods, but will consider a waiver of penalties and some interest on a case-by-case basis and upon all the facts and circumstances.

Voluntary Disclosure: Considerations

The practice described in TIR 2016-02 does not differ much from TIR 2010-07. Hawaii’s policy can still 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.

As supplemented by TIR 2016-02, Hawaii’s voluntary disclosure practice *requires a sworn statement (an affidavit)* covering a number of potentially difficult issues.

The practice still 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 commit to waive penalties, although TIR 2016-02 now specifically mentions that interest may be waived. Many states waive penalties on a specified basis.

Civil penalties on tax balances can be assessed at 25% to 50% (disregard of rules or 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. TIR 2016-02 still provides little comfort on penalty and interest reduction, stating only that “the Department will consider wavier of penalties and some interest 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*.

Taxpayers considering a voluntary disclosure have a number of difficult decisions. The making of changes to existing tax positions, whether filing returns or amending returns, is an admission 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, particular one supported by a sworn statement, 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 should consult with appropriate tax professionals to meaningfully evaluate their situation. This article is only intended as an overview and should not be considered as, or relied upon, as legal advice.