No. CAAP-16-0000462

IN THE INTERMEDIATE COURT OF APPEALS

STATE OF HAWAI`I

TAX FOUNDATION OF HAWAI`I, a Hawai`i non-profit corporation, on behalf of itself and those similarly situated,

Plaintiff/Appellant,

vs.

STATE OF HAWAI`I,

Defendant/Appellee.

Civil No. 15-1-2020-10

APPEAL FROM THE:

(1) FINAL JUDGMENT FILED JUNE 1, 2016 AND (2) ORDER GRANTING DEFENDANT'S MOTION TO DISMISS COMPLAINT FILED ON OCTOBER 21, 2015 (FILED ON NOVEMBER 10, 2016), FILED MAY 16, 2016

FIRST CIRCUIT COURT, STATE OF HAWAII

The Honorable Edwin C. Nacino, Judge

PLAINTIFF/APPELLANT TAX FOUNDATION OF HAWAI`I'S OPENING BRIEF

STATEMENT OF RELATED CASES

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PLAINTIFF/APPELLANT TAX FOUNDATION OF HAWAI`I'S OPENING BRIEF

I. NATURE OF THE CASE AND INTRODUCTION

The Tax Foundation of Hawaii (the "Foundation" or "Appellant"), on behalf of itself and those similarly situated Honolulu taxpayers, filed this action to obtain declaratory and injunctive relief in the nature of mandamus against the State of Hawai`i ("State"). The Foundation contends the State is violating HRS § 248-2.6 ("Section 2.6") by retaining the entire 10% of the half-percent (0.5%) surcharge (the "Surcharge") on the General Excise Tax ("GET") and Use Tax that the Department of Taxation ("DOTAX") assesses and collects on behalf of the City and County of Honolulu ("Honolulu") to fund Honolulu's multi-billon dollar rapid transit project. Section 2.6[1] requires the State to (1) collect 10% of the Surcharge (the "10% Fee"), (2)

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[1] Section 2.6—the controlling statute—says (emphasis added):

> (a) . . . Out of the revenues generated by County surcharges on State tax paid into each respective State treasury special account, the director of finance shall deduct ten per cent of the gross proceeds of a respective County's surcharge on State tax to reimburse the State for the costs of assessment, collection, and disposition of the County surcharge on State tax incurred by the State. Amounts retained shall be general fund realizations of the State.
>
> (b) The amounts deducted for costs of assessment, collection, and disposition of County surcharges on State tax shall be withheld from payment to the Counties by the State out of the County surcharges on State tax collected for the current calendar year.
>
> **(**c) For the purpose of this section, the costs of assessment, collection, and disposition of the County surcharges on State tax shall include any and all costs, direct or indirect, that are deemed necessary and proper to effectively administer this section and sections 237-8.6 and 238-2.6.
>
> **(d) After the deduction and withholding of the costs under subsections (a) and (b), the director of finance shall pay the remaining balance on quarterly basis to the director of finance of each County** . . . . The quarterly payments shall be made after the County surcharges on State tax have been paid into the State treasury special accounts or after the

(continued...)

calculate its costs and then (3) pay the Surcharge to the County minus **only** an amount sufficient to cover the costs it actually incurred in assessing, collecting, and disbursing the Surcharge. The State contends no cost calcuation is required, and it can keep the entire 10% Fee, even though, year in and year out, the amount it has kept is all, or nearly all, of DOTAX's entire budget. To date, the State has retained over $177 million, which is over $150,000,000.00 too much based upon the available data. ROA[2] 1:145, 148, and 150-51.

The State filed a motion to dismiss based upon jursdictional arguments [ROA 1:40-86] and the parties filed cross-motions for summary judgment. ROA 1:195-282 and 1:286-537. The Foundation argued that Section 2.6 permitted the State only to retain the costs identified in Section 2.6(c). *Id.* at 1:208-11. The State argued that it is entitled to keep the entire 10% Fee, regardless what its actual costs are (and, further, it professed an inability to calculate the "real" costs). *Id.* at 293-98.

Instead of addressing the merits of the Foundation's argument, Judge Nacino ruled that he had no jurisdiction over this dispute based upon the prohibition on declaratory judgment actions relating to taxes set forth in HRS §632-1.[3] *See* ROA 1:574. He was wrong. This is NOT

(...continued)

> disposition of any tax appeal, as the case may be. All County surcharges on State tax collected shall be distributed by the director of finance to the County in which the County surcharge on State tax is generated and shall be a general fund realization of the County, to be used for the purposes specified in section 46-16.8 by each of the Counties.

[2] The Record on Appeal ("ROA") has two volumes. The ROA will be cited according to volume and PDF page number.

[3] The relevant portion of HRS § 632-1 states:

> In cases of actual controversy, courts of record, within the scope of their respective jurisdictions, shall have power to make binding adjudications of right, whether or not consequential relief is, or at the time could be, claimed, and no action or proceeding
>
> (continued...)

a dispute over taxes. The Foundation did not, and does not, dispute any aspect of its liability—or any taxpayer's liability— for the Surcharge. It does not seek to impede the collection of the Surcharge in any manner. Rather, the Foundation's claim arises from, and involves, **only** what the State does **after** the Surcharge has been assessed, collected, and deposited into the State's coffers. The only issue is whether the State has overreached by diverting amounts far in excess of the costs it actually incurs in assessing, collecting, and disbursing the Surcharge to Honolulu.

Circuit Court Judge Nacino dismissed the Foundation's complaint without leave to amend on the basis that the Circuit Court lacked jurisdiction. He ruled this case presented a non-justiciable "controversy with respect to taxes." He was wrong on that issue; he should have entered judgment for the Foundation based upon the parties' cross-motions for summary judgment.

The Foundation's claim is indistinguishable from the one at issue in *Hawaii Insurers Council v. Lingle*, 117 Hawai`i 454, 184 P.3d 769 (Ct. App. 2008), *aff'd in part and rev'd in part on other grounds*, 120 Hawai`i 51, 201 P.3d 564 (2008). There, the Plaintiff complained about the collection and disposition of amounts which it said were illegal taxes. The Intermediate Court of Appeals explained:

> The State also argues that the circuit court lacks jurisdiction over actions for declaratory relief concerning taxes. The State cites to HRS 632-1 (1993) and HRCP Rule 57, which exclude tax matters from the jurisdiction of the State Courts of Hawai`i. This argument fails because this case is not "a controversy with respect to taxes" within the meaning of 632-1 or Rule 57. HRS 632-1 was amended in 1972 to mirror the exception in the Federal

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> shall be open to objection on the ground that a judgment or order merely declaratory of right is prayed for; provided that **declaratory relief may not be obtained in any district court, or in any controversy with respect to taxes . . . . Controversies involving the interpretation of** . . . **statutes . . . may be so determined** . . . .

> Declaratory Judgment Act, 28 U.S.C. 2201. 1972 Haw. Sess. L. Act 89, 1 at 338. The Federal Declaratory Judgment Act prohibits declaratory relief in tax matters to "permit the government to assess and collect taxes alleged to be due it without judicial interference." *Ingham v. Hubbell*, 462 F. Supp. 59, 64 (S.D. Iowa 1978). **The insurers here are not attempting to keep the State of Hawai`i from assessing and collecting taxes**. . . . The circuit court did not err in concluding that it had jurisdiction.

Hawaii Insurers Council, 117 Hawai`i at 462-63, 184 P.3d at 777-78. *See also Aetna Life Ins. Co. v. Park*, 5 Haw. App. 122, 678 P.2d 1104 (1984) (*"Aetna Life"*) (complaint seeking declaratory relief, refunds **and** an injunction was not barred by HRS §632-1 because the taxpayer requested a refund).

Since the Circuit Court clearly erred in dismissing this case, the Circuit Court's *Order Granting Defendant's Motion to Dismiss Complaint filed on October 21, 2015 (filed on November 10, 2015)* ("Order") and *Final Judgment* ("Judgment") must be reversed. The Court should remand with directions to enter judgment in the Foundation's favor because the merits are clear.

II. CONCISE STATEMENT OF THE CASE

A. Background

1. The Adoption and Implementation of the Surcharge

In 2005, the State Legislature enacted Act 247, a portion of which is codified in Section 2.6. Its purpose was to provide tax revenue to the counties for transit and other specified projects. Specifically, Section 2.6 allows each County to impose a surcharge of one-half per cent on top of the State's GET. Under Section 2.6, DOTAX assesses and collects the Surcharge and transmits those funds to the State Department of Budget and Finance ("B&F"). ROA 1:106.

Then, under Section 2.6(a), the head of B&F places the Surcharge collected for each County into a special account from which he "deduct[s] and withhold[s] . . . the costs [of

assessment, collection, and disposition]", and "pay[s] the remaining balance on a quarterly basis to . . . each County." ROA 1:107. Currently, only Honolulu has adopted a surcharge.[4] *Id.*

> Section 2.6(c) says:
>
> For the purpose of this section, the costs of assessment, collection, and disposition of the County surcharges on State tax shall include any and all costs, direct or indirect, that are deemed necessary and proper to effectively administer this section and sections 237-8.6 and 238-2.6.[5]

This definition is designed to avoid two problems:

- It prevents the State from bearing an uncompensated burden associated with any County-imposed surcharge(s); and
- It prevents such surcharge(s) from becoming a back-door, discriminatory increase of the State-level GET burden by assuring the County receives all the tax revenue net of the State's expenses.

2. In conjunction with the Enactment of Act 247, the State Estimated the Costs It Would Incur in Implementing and Administering Section 2.6

On March 21, 2005, when the Legislature was considering the bill that became Act 247, then-DOTAX director, Kurt Kawafuchi, submitted written testimony to the Senate Committee on Transportation & Government Operations opposing the idea that the State (through DOTAX) would collect the Surcharge. ROA 1: 129-131. Director Kawafuchi testified that imposing on the DOTAX would "seriously detract from [DOTAX's] own efforts to maximize State collections and w[ould] utilize Department resources to enforce the County tax."

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[4] Honolulu enacted Ordinance No. 05-027, codified as Revised Ordinance of Honolulu ("ROH") §§6-60.1 – 6-60.3 to fund Honolulu's mass transit rail project ("rail") effective January 1, 2007. ROA 1:107.

[5] HRS § 237-8.6 provides for exceptions to the surcharge (e.g., for wholesale transactions taxed at .5%), for under-reporting and non-filing penalties, and other filing deadlines. HRS § 238-2.6 extends the surcharge to the Use Tax.

Id. at 129. Director Kawafuchi testified that DOTAX would not be able to implement a system to collect until July 1, 2006 "due to the need to produce new forms, reprogram the computers to accept additional data entries, train staff and educate the public about the taxes." *Id*. at 130. And, "[i]n order to administer the tax", he estimated that DOTAX needed "a one time appropriation of $3.6 million for hardware, software, and equipment and $2.5 million annually thereafter for recurring staffing and operational costs." *Id* at 131.

On April 5, 2005, Director Kawafuchi gave similar testimony to the Senate Committee Ways and Means on the same bill. ROA 1:132-135.

3. DOTAX Received Additional Staffing and Funding for the Surcharge of Very Modest Amounts

On April 27, 2007, Governor Linda Lingle signed Act 45, which made an emergency appropriation of "$5,041,691 or so much thereof as may be necessary for fiscal year 2006-2007 to reimburse the department of taxation for costs incurred in implementing and administering the County surcharge…including the costs of the computer vendor." ROA 1:136-141.

The Legislature also required DOTAX to provide two years of reporting "detailing the level of staffing and funding necessary to administer County surcharge collection; provided further that the report shall describe the total workload related to collection of the County surcharge, provide a listing of staff that support the collection of the County surcharge, the budgeted annual salary for each position, and the approximate percentage of time each position spends on the task." ROA 1:142-143.

In the first report, DOTAX reported that it was granted 19 permanent positions and 4 temporary positions for fiscal year 2008 and 19 permanent positions and 1 temporary position for fiscal year 2009. ROA 1:144-146. The "[t]otal amount budgeted" for these

positions was "$749,876 for fiscal year 2008 and $700,508 for fiscal year 2009." *Id.* at 145. The Report concluded by "[t]he success of the implementation and administration of the County Surcharge tax on the State's general excise tax on behalf of the City and County of Honolulu" and noted that "[w]hen necessary, [DOTAX] will submit a request for additional resources to enhance compliance with the new law." *Id.* at 146.

The second report was substantially similar to the first. ROA 1:147-149. It added that DOTAX estimated that the pro rata share of staff costs due to the County Surcharge for its compliance division was $439,166. *Id.* at 148. The report concluded by noting the denial of a relatively modest $233,000 request for additional computer support, but also stating that "[t]he administration of the County Surcharge tax has been relatively smooth to the Department's knowledge". *Id.* at 149.

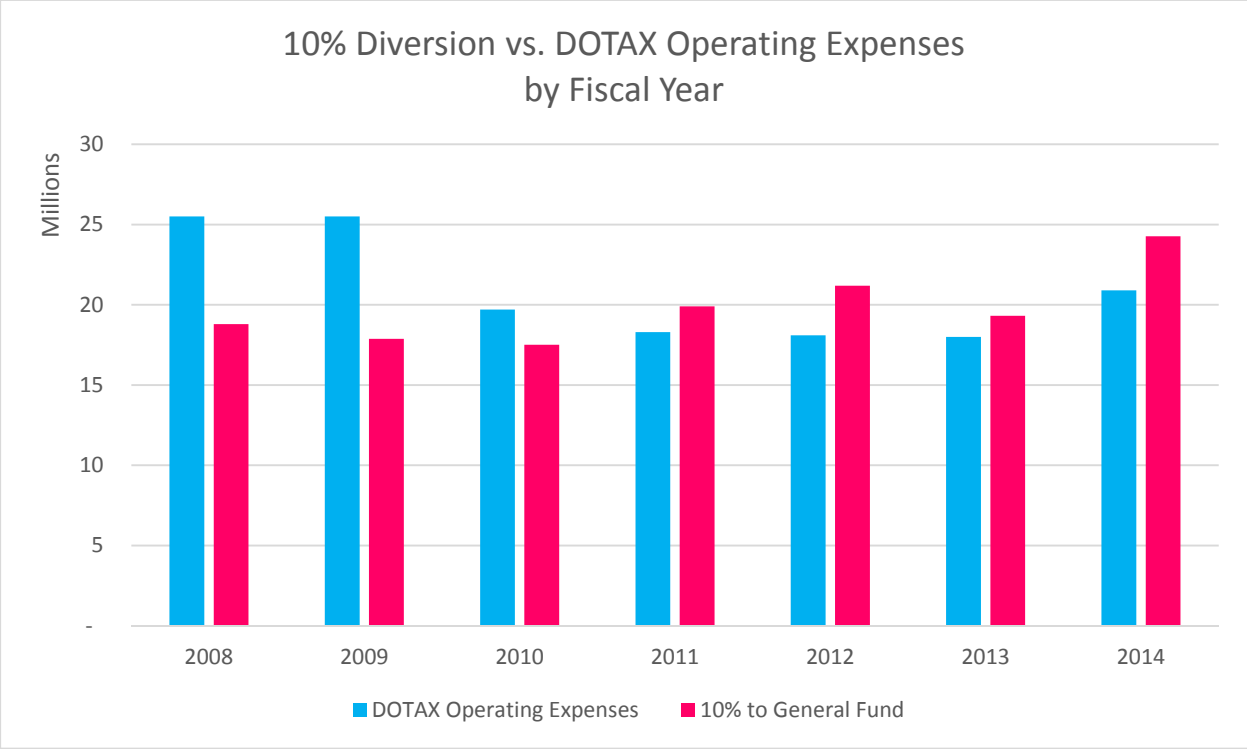
However, DOTAX has not subsequently calculated the actual costs of assessing, collecting, and distributing the Surcharge. ROA 1:184-185. (Testimony of HRCP 30(b)(6) designee, Ted Shiraishi[6]). DOTAX feels it is not "necessary or required" to do that analysis. *Id.* at 185.

4. As of December 31, 2015, the State Has $177,865,487.24 in Its Coffers from The County Surcharge As Its 10% Deduction, Not Related to Any Cost Calculation

During discovery, the State produced a chart detailing, on a quarterly, annual and cumulative basis, the amount of the County Surcharge collected by the State and the amount kept by the State as its 10% Fee. ROA 1:150. The chart shows that from the inception of the Surcharge through December 31, 2015, the State paid itself $177,865,487.24 of the County Surcharge , ostensibly for its services in collecting the Surcharge. *Id.* DOTAX also provided

[6] Ted Shiriashi, an attorney, is the DOTAX's Administrative Rules Officer. He previously served as the Acting Deputy Director of Taxation.

certain "Annual Reports." ROA 1:152-159. The evidence shows that in four out of seven fiscal years (2008-2014) DOTAX's total operating expenses have been less than the 10% Fee. ROA 1:151.



Source: Chart created from DOTAX Annual Reports and documents produced during discovery.

Obviously, DOTAX does much more than collect the Surcharge. Thus, there is no genuine dispute that the 10% Fee the State has kept greatly exceeds what it actually costs, to assess, collect, and dispose of the Surcharge. ROA 1:151.

B. Procedural History

On October 21, 2015, the Foundation filed its Complaint against the State. ROA 1:11-24. The Foundation sought a declaratory ruling regarding the dispute over the proper interpretation of Section 2.6—which is exactly what HRS § 632-1 allows. It also sought equitable relief compelling the State to distribute all the funds it has retained in excess of the costs allowed under Section 2.6(c). *Id.*

On November 10, 2015, the State moved to dismiss Appellant's Complaint for lack of standing[7] and lack of subject matter jurisdiction. *Id.* at 40-86. On January 4, 2016, Appellant deposed the State's 30(b)(6) representative – Ted Shiraishi. ROA 1:181. On January 21, 2016, Appellant moved for summary judgment on the Complaint. *Id.* at 1:195-282. On March 4, 2016, the State filed its cross-summary judgment motion. *Id.* at 286-537. On March 23, 2016, the Court heard the State's Motion to Dismiss and the two motions for summary judgment. Court Tr.[8] 2:24-25 and 3:1-2.

After hearing argument, Judge Nacino addressed the State's motion to dismiss and ruled that the Complaint is a "[HRS §] 632-1 argument" and "it's a controversy arising out of a tax." Court Tr. 31:14-19. While suggesting Appellant's claims could be addressed in the Tax Appeal Court,[9] Judge Nacino dismissed the Complaint without leave to amend. *Id.* at 34:14-16. The Order Granting Defendant's Motion to Dismiss was entered on May 16, 2016. ROA 1:573-574. Final Judgment was entered on June 1, 2016. *Id.* at 575-576. The Court made no ruling on the parties' cross-motions for summary judgment. *Id.* at 574.

III. STATEMENT OF POINTS OF ERROR

The Circuit Court erred in granting the State's motion to dismiss on the premise that the Circuit Court had no jurisdiction because the Foundation's complaint involved a

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[7] The State argued that the Foundation was not a taxpayer. ROA 1:43 and 57. The Foundation disproved this argument by submitting its 2014 Form G-45 showing it paid $363.83 GET in 2014 [ROA 1: 23 and164] and 2015 Form G-45 showing it paid $619.65 GET in 2015 [*Id.* at 23 and 168].

[8] The Transcript of the hearing ("Court Tr.") is filed as Dkt #23.

[9] The idea that the Foundation's claim can be resolved in the Tax Appeal Court is simply wrong. HRS § 232-13 expressly limits that Court's jurisdiction to determining "the amount of valuation of taxes, as the case may be, in dispute." Here, there is no dispute about any aspect of any taxpayer's liability for GET or the Surcharge.

controversy seeking declaratory relief with respect to taxes, despite the ruling in *Hawaii Insurers Council v. Lingle,* 117 Hawai`i 454, 184 P.3d 769 (Ct. App. 2008), *aff'd in part and rev'd in part on other grounds* 120 Hawai`i 51, 201 P.3d 564 (2008). This error was preserved in the memoranda opposing the State's motion to dismiss and the State's cross-motion for summary judgment (ROA 1:113 and 1:545) and during the oral argument on those motions.

The Circuit Court also erred in not granting the Foundation's summary judgment motion. This error was preserved in the memorandum opposing the State's summary judgment motion (ROA 1:543-550) and during the oral argument on the parties' cross motions for summary judgment. Court Tr. 33:4-25 and 34:1-13.

Finally, at minimum, the Circuit Court erred in not allowing the Foundation the opportunity to amend its complaint. This error was preserved during the oral argument on the parties' cross motions for summary judgment. Court Tr. 33:9-25 and 34:1-16.

IV. STANDARD OF REVIEW

1. Dismissal for lack of jurisdiction is reviewed *de novo,* that is under a right/wrong standard. *Aames Funding Corp. v. Mores,* 107 Hawai`i 95, 98, 110 P.3d 1042, 1045 (2005). *See also, Casumpang v. ILWU, Local 142,* 94 Hawai`i 330, 337, 13 P.3d 1235, 1242 (2000) ("A trial court's dismissal for lack of subject matter jurisdiction is a question of law, reviewable *de novo.*"). "Dismissal is improper unless 'it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.'" *Norris v. Hawaiian Airlines, Inc.*, 74 Haw. 235, 240, 842 P.2d 634, 637 (1992), *aff'd, Hawaiian Airlines, Inc. v. Norris*, 512 U.S. 246 (1994) (quoting *Love v. U.S.*, 871 F.2d 1488, 1491 (9th Cir. 1989)). Moreover, the court in a 12(b)(1) motion "may review any evidence . . . to resolve factual disputes concerning the existence of jurisdiction." *Id.*

2. As to summary judgment questions, the Supreme Court has explained:

> Unlike other appellate matters, in reviewing summary judgment decisions an appellate court steps into the shoes of the trial court and applies the same legal standard as the trial court applied." *Beamer v. Nishiki*, 66 Haw. 572, 577, 670 P.2d 1264, 1270 (1983). "[The appellate] court reviews a circuit court's grant or denial of summary judgment de novo." *Bremer v. Weeks*, 104 Hawai'i 43, 51, 85 P.3d 150, 158 (2004) (*quoting Hawai'i Cmty. Fed. Credit Union v. Keka*, 94 Hawai'i 213, 221, 11 P.3d 1, 9 (2000)).
>
> [S]ummary judgment is appropriate if the pleadings, depositions, answers to interrogatories, and admissions on file, together, with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. A fact is material if proof of that fact would have the effect of establishing or refuting one of the essential elements of a cause of action or defense asserted by the parties. The evidence must be viewed in the light most favorable to the non-moving party. In other words, we must view all of the evidence and the inferences drawn therefrom, in the light most favorable to the party opposing the motion.

Omerod v. Heirs of Kaheananui, 116 Hawai`i 239, 254-55, 172 P.3d 983, 998-99 (2007) (citations omitted) (emphasis added); *Blaisdell v. Dep't of Public Safety*, 119 Hawai`i 275, 282, 196 P.3d 277, 284 (2008).

Here, the Circuit Court never reached the parties' cross-motions for summary judgment, but this Court should compel the State to disgorge the millions of dollars illegally diverted into the State's coffers. Given the amounts involved and the well-known economic plight of the Honolulu rail project, there is no good reason to delay resolution of the dispositive issue of law, which the parties briefed fully and submitted for decision on summary judgment. *Cf.* HRS §602-5(a)(3)(creating original jurisdiction to issue mandamus relief); HRS §602-5(a)(6)(creating jurisdiction to issue judgments or the promotion of justice in pending matters); and HRAP 18 (submission of original actions on agreed facts).

3. "Orders denying motions for leave to amend a complaint are reviewed for an abuse of discretion." *Office of Hawaiian Affairs v. State*, 110 Hawai`i 338, 351, 133 P.3d 767, 780 (2006).

V. ARGUMENT

A. This Case Is Not Merely An Effort to Obtain Declaratory Relief and, In Any Event, The Requested Declaratory Ruling Would Not Affect the Assessment or Collection of Taxes

1. The Declaratory Relief Sought Has No Impact on the Assessment or Collection of Taxes

Among other things, Plaintiff sought declaratory relief to establish Section 2.6 permits the State to keep only the costs it actually incurs performing its statutory obligations. ROA 1:19-20. Regardless how the Court might have resolved that issue, it would not have affected the State's ability to assess or collect either the GET or the Surcharge.

In its motion to dismiss, the State (mis)characterized this case as matter involving a "tax **refund** controvers[y]" [ROA 1:47] barred under HRS § 632-1 by relying on *In the Matter of Tax Appeal of Grace Business Development Corp.*, 92 Hawai`i 608, 994 P.2d 540 (2000). ROA 1:47-48. *Grace Business Development Corp.* is irrelevant. In that case, a taxpayer paid GET and a transient accommodations tax **under protest** and then sought a declaratory ruling to contest its liability for these taxes. The Hawai`i Supreme Court rightly found that there was no jurisdiction under these circumstances. *Grace Business Development Corp.*, at 613, 994 P.2d at 545.

In reality, Appellant's claims closely mirror the claims those asserted in *Hawaii Insurers Council v. Lingle*, 117 Hawai`i 454, 184 P.2d 769 (Ct. App.), *aff'd in part and rev'd in part on other grounds* 120 Hawai`i 51, 201 P.3d 564 (2008). In *Hawaii Insurers Council*, an insurance trade association filed an action challenging, among other things, a legislative raid on

the DCCA's compliance resolution fund ("CFR") which led to regulatory assessments imposed on insurers under HRS § 431:2-215 being diverted into the State's general fund. As here, the State argued that the Circuit Court lacked jurisdiction, in part, because the lawsuit violated the prohibition against declaratory relief actions regarding taxes under HRS § 632-1. The Intermediate Court of Appeals rejected that argument holding that the prohibition against actions regarding taxes under HRS § 632-1 did not apply because the Council was not attempting to keep the State from assessing and collecting taxes. *Id.* at 462, 201 P.3d at 777.[10]

Inexplicably, here, the Circuit Court failed to apply the rule of *Hawaii Insurers Council* and disregarded the rule of *Aetna Life* by ignoring the substantive relief sought by the Foundation. The Foundation sought to compel the transfer of funds (as in *Hawaii Insurers Council*) and other relief (as in *Aetna Life*) the Foundation did not (and does not):

- Dispute that the Surcharge is rightfully taxed under the Honolulu County ordinance; or
- Seek a ruling that will in any way interfere with the State's ability to impose and collect the Surcharge.

Rather, this action seeks only to stop the State from keeping more than its share of the Surcharge and force it to disgorge the funds that rightly belong to Honolulu.

Judge Nacino (mis)applied *San Juan Cellular Telephone Co. v. Public Comm'n of Puerto Rico* 967 F.2d 683 (1st Cir. 1992), which this Court applied in *Hawaii Insurers Council* to determine whether the disputed assessments were "taxes" or " regulatory" fees. He said that

[10] The Supreme Court upheld part of the ICA's ruling and determined that the funds raided from the CRF and transferred to the State's general fund had to be returned to the CRF. Having given this substantive relief, the Supreme Court declined to address the State's argument under HRS § 632-1. *See* 120 Hawai`i at 72 n. 15.

Appellant's complaint involved "a tax, an imposition of a tax upon – well, a tax. And because of that it does invoke [HRS §] 632-1." Court Tr. 2:15-17. He was wrong, not because the Surcharge isn't a "tax," but because the ruling the Foundation seeks has no impact on the assessment or collection of the Surcharge. The Circuit Court had jurisdiction over Appellant's claim.

2. Since the Foundation Sought Substantive Relief, the Action Was Not Subject to Dismissal

The decisions in *Hawaii Insurers Council* and *Aetna Life Ins. Co. v. Park*, 5 Haw.App. 122, 678 P.2d 1104 (1984) (complaint seeking declaratory relief, refunds and an injunction was not barred by HRS §632-1) establish that the case should not have been dismissed. In both of those cases, the plaintiffs overcame objections based upon §632-1 by seeking other relief. Judge Nacino should have followed the same course here.

B. Both the Circuit Court and this Court Should Determine the State's Rights and Obligations Under Section 2.6 Without Delay

At bottom, this case is about a simple question of statutory interpretation:—does Section 2.6 allow the State to keep the entire 10% Fee? If not, then as in *Hawaii Insurers Council* the State must transfer the excess funds to the rightful owner. If so, this case is over.

This Court can, and pursuant to HRE 201 should, take judicial notice of the economic woes facing Honolulu because of the burgeoning cost of its rapid transit project. Obviously, the public interest requires a quick answer to the question about Section 2.6.

Applying the plain language of Section 2.6, this Court should find that Section 2.6 requires the State through its agencies DOTAX and B&F, to calculate its costs to collect, assess, and dispose of the Surcharge, subtract those costs from the 10% Fee, and remit the balance to Honolulu. Any other construction of Section 2.6 would render it unconstitutional. Meanwhile, as noted above, the State admits that it has never even attempted to calculate these costs.

Instead, it admits having retained the full amount of the 10% deduction since 2007. Under these undisputed facts, Plaintiff is entitled to judgment as a matter of law on all claims in its Complaint.

1. Legal Standards Governing Construction of Section 2.6

Well-established Hawai`i principles regarding statutory construction guide the disposition of this case. In particular,

> [T]he fundamental starting point for statutory interpretation is the language of the statute itself. *Second*, where the statutory language is plain and unambiguous, our sole duty is to give effect to its plain and obvious meaning. *Third*, implicit in the task of statutory construction is our foremost obligation to ascertain and give effect to the intention of the legislature, which is to be obtained primarily from the language contained in the statute itself. *Fourth*, when there is doubt, doubleness of meaning, or indistinctiveness or uncertainty of an expression used in a statute, an ambiguity exists. And *fifth*, in construing an ambiguous statute, the meaning of the ambiguous words may be sought by examining the context, with which the ambiguous words, phrases, and sentences may be compared, in order to ascertain their true meaning.

Hawaii Gov't Emp. Ass'n, AFSCME Local 152, AFL-CIO v. Lingle, 124 Hawai`i 197, 202, 239 P.3d 1, 6 (2010) (quoting *Awakuni v. Awana*, 115 Hawai`i 126, 133, 165 P.3d 1027, 1034 (2007) (citations omitted)).

In addition, "[i]t is a cardinal rule of statutory construction that courts are bound, if rationale and practical, to give effect to all parts of a statute, and that no clause, sentence, or word shall be construed as superfluous, void, or insignificant if a construction can be legitimately found which will give force to and preserve all the words of the statute." *Dines v. Pacific Insurance Co.*, 78 Hawai`i 325, 331, 893 P.2d 176, 182 (1995) (quoting *Camara v. Agsalud*, 67 Haw. 212, 215-16, 685 P.2d 794, 797 (1984) (citations omitted).

Moreover, the "doctrine of 'constitutional doubt', a well settled canon of statutory construction, counsels that, 'where a statute is susceptible of two constructions, by one of which

grave and doubtful constitutional questions arise and by the other of which such questions are avoided, [the court's] duty is to adopt the latter.'" *In re Doe*, 96 Hawai`i 73, 81, 26 P.3d 562, 570 (2001) (quoting *Jones v. United States*, 529 U.S. 848, 857 (1909)).

2. Section 2.6 Requires that the State Calculate the Costs to Administer the Surcharge and Remit the Remaining Balance to Honolulu

Section 2.6 instructs the State in subsection (a) to initially deduct 10% of the gross proceeds of the County Surcharge "to reimburse the State for the costs of assessment, collection, and disposition of the County surcharge on State tax incurred by the State." Subsection (b) requires that the "amounts deducted for costs of assessment, collection, and disposition of the County surcharge shall be withheld from payment to the counties by the State." Subsection (d) then provides that "after the deducting and withholding of the costs under subsections (a) and (b), the director of finance shall pay the remaining balance" to the counties.

Section 2.6 is clear and unambiguous. Subsections (b) and (c) mandate that the State, after deducting 10% of the total tax collected per subsection (a), withhold from payment to the State only those costs incurred by the State in the assessment, collection, and disposition of the surcharge before returning the "remaining balance" to the counties. However, as admitted by Mr. Shiraishi in his deposition, the State has, in practice, kept the initial 10% deducted pursuant to subsection (a), even though it knows that that amount does not reflect the cost of the assessment, collection, and distribution of the Surcharge.

The State's defense of its conduct appears to be its understanding that the 10% Fee is "a set amount" that it was entitled to keep.

However, this construction of Section 2.6 is untenable. It ignores the requirements in subsections (b) and (d) that D&F send the "balance" to the Counties after deducting the "costs" defined in subsection (c). Under the State's reading, subsections (b), (c),

and (d) become superfulous, except insofar as they prescribe timing of payments. The State simply takes its 10% Fee, even though it is indisputable that this amount bears no relationship to the costs it has been tasked to deduct, and -- given that the 10% Fee exceeds the operating expenses of DOTAX – no doubt, grossly exceeds those costs. The State's construction of the statute must be rejected because it fails to "'give force to and preserve all the words of the statute.'" *Dine*, 78 Hawai`i at 331, 893 P.2d at 182 (quoting *Camara*, 67 Haw. at 216, 685 P.2d at 797). In addition, it would frustrate legislative intent as the fundamental reason for Section 2.6 was to allow counties additional taxing authority to fund **programs specific to that County –** not to fund statewide programs through diversion of amounts in excess of the State's "costs. "

3. The State's Interpretation and Implementation of Section 2.6 is Unconstitutional

As noted above, since the 10% Fee bears no relation to the State's actual costs of administering the Surcharge, the Foundation and similarly situated taxpayers have been paying and continue to pay a higher GET than that imposed on State taxpayers of other Counties. This is unconstitutional by violating the generals laws provision and the Equal Protection Clause of the Hawai`i State Constitution.

a. The State's Reading of Section 2.6 violates the General Laws Provision of the Hawai`i State Constitution

This Court should consider whether the State's reading of Section 2.6 comports with the uniformity contemplated in HRS Chapter 237. It does not and therefore, if the State's reading stands, the Foundation and the Honolulu taxpayers will suffer unconstitutional discrimination.

A general law "applies uniformly throughout all political subdivisions of the State." *Bulgo v. Maui County*, 50 Haw. 51, 58, 430 P.2d 321, 326 (1967); *see also Sierra Club v. Dep't of Transp. of State of Hawai`i*, 120 Hawai`i 181, 202 P.3d 1226 (2009) *as amended* (May

13, 2009) ("A general law must apply uniformly.") "A law that applies uniformly to a particular class may also be a general law if: 1) the class created is genuine and not logically limited to a class of one and thus illusory, and 2) the class created is reasonable." *Sierra Club*, 120 Hawai`i at 214, 202 P.3d at 1259.

HRS Chapter 237 imposes the General Excise Tax Law upon the taxpayers of Hawai`i who engage in business. *See* HRS § 237-13 ("Imposition of tax"). This tax burden applies (or should apply) uniformly to the taxpayers of Hawai`i. Section 2.6, with the correct interpretation, applies uniformly to the taxpayers whose counties adopt the Surcharge. *See* HRS § 237-8.6 ("County surcharge on State tax"). The taxpayers under HRS Chapter 237 are equally burdened. Yet, with the diversion of the 10% Fee, the Foundation and all other Honolulu taxpayers, suffer an unequal burden by being charged 4.05% GET (net of DOTAX's actual costs) while the rest of the taxpayers only pay 4.0% GET. This results in a disproportionate tax benefit to the State where the Honolulu taxpayers are padding the State's general fund for statewide programs. With the magnitude of Honolulu's economic activity, the likelihood of a windfall (surplus) to the State is greater.

There is nothing in HRS Chapter 237 that contemplates regional variations in the GET burden and to impose a higher rate just on Honolulu. To justify any disporportionate tax on just the Honolulu taxpayers, the State has to show that the Honolulu taxpayers "are distinguished by sufficiently significant characteristics to make them a class by themselves." *Bulgo,* 50 Haw. at 58, 430 P.2d at 326. As further discussed below, there is no such characteristic to create a reasonable class distinction for the Honolulu taxpayers. Therefore, the State's interpretation violates the general laws provision.

b. The State's Reading of Section 2.6 Violates the Hawai`i Equal Protection Clause

In analyzing a claim that a statute violates the Equal Protection clause of the Hawai`i Constitution, the Hawai`i Supreme Court applies a "rational basis" analysis where neither a suspect class nor fundamental right is involved. Under this analysis to avoid constitutional infirmity, the disputed statutory provision must have a rational relationship to a legitimate government interest. *State v. Nakata*, 76 Hawai`i 360, 379, 878 P.2d 699, 718 (1994).

In *Hasegawa v. Maui Pineapple Co.*, 52 Haw. 327, 475 P.2d 679 (1970), the Hawai`i Supreme Court employed a two-pronged test for determining whether a rational basis exists. In *Hasegawa*, the Legislature required private employers with more than 25 employees to continue to pay the wages of employees who were absent from work because they were selected for public service, *e.g.* jury duty, public boards, and public commissions. In analyzing if a rational basis existed for the legislation, the Supreme Court stated:

> *First* we must ascertain the **purpose or objective** that the State sought to achieve in enacting [the statute]. *Second*, we must **examine the means chosen to accomplish that purpose**, to determine whether the means bears a reasonable relationship to the purpose.

Id. at 330. (emphasis added.)

The Supreme Court then found that the legislation was unconstitutional because it created a "class distinction" of private employers burdened to pay for State functions to benefit the general public and not benefit the class members. The State failed to "demonstrate[] any special benefit to private employers that would justify this class distinction." *Id.* at 332. "The cost of a proper State function conducted for the public benefit cannot be arbitrarily charged to one class in the society." *Id.* at 333. (internal citations omitted).

Applying this analysis to the State's interpretation and implementation of Section 2.6, renders this statute unconstitutional.

i. The Purpose of Section 2.6 is to allow Counties to raise money for Specific Projects.

The first prong of analysis for the rational basis test is determining the Legislature's purpose in enacting Section 2.6. The purpose of Section 2.6 was primarily to enable the County of Honolulu to raise funds for its mass transit rail system. In so doing, the Legislature granted Honolulu (as well as other counties) further taxing authority to raise capital to fund the public transportation system for that particular County. Since the Surcharge was added to the GET (a State tax), the Legislature reasonably concluded that for efficiency purposes the State agencies – DOTAX and B&F – would collect, assess, and administer the Surcharge. The State would be reimbursed for the additional costs associated with doing so.

Honolulu exercised this taxing authority by imposing the Surcharge to fund its ambitious rail transit system. The State can point to no law or testimony that the purpose of the statute was, instead, simply to increase the monies into the State's general fund to be used for statewide programs.

ii. The State's interpretation and implementation of Section 2.6 creates a separate class and an arbitrary burden on that class.

The second prong of the rational basis test looks at the mechanism to accomplish the statute's purpose. Here, Section 2.6, properly construed, is rationally calculated to achieve the legislation's purpose. Since the State is already collecting GET, reasonable efficiencies dictate that the State administer, assess, and dispose of the Surcharge. However, recognizing the potential burden and estimated costs as described by Mr. Kawafuchi (then the DOTAX director), the Legislature reasonably allowed the State to be reimbursed for all costs associated with

Surcharge, instructing the State to reimburse itself for "any and all costs, direct and indirect, that are deemed necessary and proper to effectively administer this section . . . ." *See* HRS § 248-2.6(c). Such costs could include, for example, the costs to implement the surcharge, including even the costs to determine what those implementation costs might be.

In contrast, and in violation of the statute and the Equal Protection clause, the State's interpretation ignores any need for the State to determine the costs "deemed necessary and proper to effectively administer" the law. Instead, the State simply keeps the entirety of the 10% Fee from the Honolulu taxpayers and pads the State's general fund. These general funds are then used for State functions and/or programs for **all** Hawai`i residents – not just those in Honolulu. Honolulu taxpayers are therefore a "distinctive class" under *Hasegawa* since, as a result of the 10% Fee, they alone fund State functions and/or programs available to all Hawai`i residents. In addition, because the 10% Fee itself bears no relation to State's costs to administer the Surcharge, Honolulu taxpayers are arbitrarily charged with the cost of providing this benefit to the State. This constitutes an Equal Protection violation because, as *Hasegawa* held, the cost of a State function or general public benefit cannot be arbitrarily charged to one class. *See also Dep't of v. Kirchner*, 60 Ca. 2d 716, 36 Cal. Rptr. 488, 388 P2d 720 (1964), *vacated and remanded*, 380 U.S. 194 (1965), *reaff'd* 62 Cal. 2d 586, 43 Cal. Rptr. 329, 400 P2d 321 (1965).

The State will likely argue that the additional burden on the Foundation and other Honolulu taxpayers caused by the State's 10% Fee is "justified as a special assessment imposed on a particular group in society for a special benefit they have received." *Hasegawa*, 52 Haw. at 334-35 (internal citation omitted.). The State may claim that Plaintiff receives a special benefit because under the statute, the State collects, assesses ,and administers the Surcharge on behalf of Honolulu. However, this does not constitute a special benefit since the Legislature considered

that burden when it drafted Section 2.6 and allowed the State to reimburse itself for costs that are deemed necessary to assess, collect, and distribute the Surcharge. The State cannot credibly argue that because it has never calculated (or even attempted to calculate) those costs and does not know what they are, it is justified in assessing the Foundation and Honolulu taxpayers an additional $24,000,000 a year and over $177,000,000 since 2007.

Therefore, interpreting Section 2.6 to allow the State to keep the entirety of the 10% Fee violates the Equal Protection clause of the Hawai`i Constitution. To avoid having to invalidate this legislation, this Court should confirm that the State is obligated under Section 2.6 to (1) take the steps necessary and proper to calculate its costs to assess, collect, and dispose of the Surcharge; (2) deduct only those costs from the State's coffers; and (3) transfer the remaining balance to Honolulu.

C. At Minimum, The Circuit Court Abused Its Discretion by Denying the Foundation Any Opportunity to Amend its Complaint

When the Foundation sought to address Judge Nacino's concerns by amending its complaint, he refused to grant leave to amend. To the extent any clarification was needed to evade HRS § 632-1 (it wasn't), Judge Nacino erred by not allowing the Foundation at least one opportunity to amend. Hence, even if his decision was otherwise sound (it was not), a remand with leave to amend is required.

HRCP 15(a)(2) states that leave to amend "shall be freely given when justice so requires." This rule is identical to FRCP 15, which the Hawai`i Supreme Court has used as guidance in determining whether leave to amend a complaint should have been granted. *See Bishop Trust Co., Ltd. V. Kamokila Dev. Corp.* 57 Haw. 330, 337, 555 P.2d 1193, 1197-98 (1976) (relying on the U.S. Supreme Court's general standards for FRCP 15(a) in federal courts in analyzing HRCP 15(a).) The general standard is that:

> In absence of any apparent or declared reason-such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc.-the leave sought should, as the rules require, be freely given.

Id. (citing *Foman v. Davis*, 371 U.S. 178, at 182, 83 S.Ct. 227, at 230 (1962)).

Here, the Circuit Court abused its discretion by denying the Foundation's oral motion to amend the Complaint and dismissing the entire action. Tr. 16:1-25; 33:9-25; and 34:1-16. There was no undue delay, bad faith or dilatory motive behind Appellant's request. Rather, Judge Nacino denied Appellant's request to amend its complaint stating that "[t]here can be clarification, but you cannot then say, oh, we really didn't mean a tax. We really meant a regulatory fee associated with a tax." Tr. 33:21-23.

However, the law has been clear for over 60 years, that it is *per se* error to refuse any chance to amend unless there is no possibility that a viable claim can be pleaded. As the Ninth Circuit explained in *Lopez v. Smith,* 203 F.3d 1122 (9th Cir. 2000)(en banc):

> in a line of cases stretching back nearly 50 years, we have held that in dismissing for failure to state a claim under Rule 12(b)(6), "a district court should grant leave to amend even if no request to amend the pleading was made, unless it determines that the pleading could not possibly be cured by the allegation of other facts."

Id. at 1127. (citing *Doe v. United States*, 58 F.3d 494, 497 (9th Cir. 1995)).

Appellant was not afforded the opportunity to address the Court's concerns through an amended complaint which would have made clear—if any clarity was required—that (1) the Foundation is **not** (to paraphrase ICA's words in *Hawaii Insurers Council*) "attempting to keep the government from assessing and collecting taxes." And, (2) if that was not enough, the Foundation would have focused attention more clearly on the substantive relief it seeks which

was enough to sustain the claim in *Aetna Life Ins. Co. v. Park*, 5 Haw. App. 122, 678 P.2d 1104 (1984), and it should suffice here.[11]

In sum, if the claims in the current complaint are deficient in some manner (which they are not), it was *per se* error to deny leave to amend and the dismissal order should be set aside for that reason alone.

VI. CONCLUSION

For the reasons set forth above, the Circuit Court's ruling should be reversed and the matter remanded.

DATED: Honolulu, Hawai`i, August 25, 2016.

/S/ PAUL ALSTON
PAUL ALSTON
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TAX FOUNDATION OF HAWAI`I, a Hawai`i nonprofit corporation, on behalf of itself and those similarly situated

[11] The Foundation is entitled to injunctive relief in the nature of mandamus because it, along with the other Honolulu taxpayers, are suffering an illegal economic burden and unconstitutional discrimination at the hands of the State, and there is not other available remedy. The Circuit Court is able to (and should) provide such relief. *See* HRS §603-21.7(2) ("The several circuit courts shall have jurisdiction… (2) of actions or proceedings in or in the nature of … mandamus..."). Moreover, "if there is a continuing violation of an ongoing breach resulting from a past action, then prospective relief, i.e., an injunction to stop the continuing violation, is available." *Office of Hawaiian Affairs v. State*, 110 Hawai`i 338, 357, 133 P3d 767, 786 (2006). Here, the State continues to violate the plain reading of Section 2.6. An injunction is appropriately issued here to prevent the State from continuing to kept the entirely of the 10% Fee and to compel the State to disgorge its coffers of the amounts it was required to repay since the inception of Section 2.6.

No. CAAP-16-0000462

IN THE INTERMEDIATE COURT OF APPEALS

STATE OF HAWAI`I

TAX FOUNDATION OF HAWAI`I, a Hawai`i non-profit corporation, on behalf of itself and those similarly situated, Plaintiff/Appellant, vs. STATE OF HAWAI`I, Defendant/Appellee.	Civil No. 15-1-2020-10 **APPEAL FROM THE:** **(1) FINAL JUDGMENT FILED JUNE 1, 2016 AND (2) ORDER GRANTING DEFENDANT'S MOTION TO DISMISS COMPLAINT FILED ON OCTOBER 21, 2015 (FILED ON NOVEMBER 10, 2016), FILED MAY 16, 2016** **FIRST CIRCUIT COURT, STATE OF HAWAII** The Honorable Edwin C. Nacino, Judge

STATEMENT OF RELATED CASES

The Foundation is not aware of any related cases.

DATED: Honolulu, Hawai`i, August 25, 2016.

/S/ PAUL ALSTON
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Attorneys for Plaintiff/Appellant
TAX FOUNDATION OF HAWAI`I, a Hawai`i nonprofit corporation, on behalf of itself and those similarly situated

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing document will be served on counsel of record indicated below through JEFS upon the filing hereof:

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DATED: Honolulu, Hawai`i, August 25, 2016.

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