THOMAS YAMACHIKA 3504

TAX FOUNDATION OF HAWAIʻI
126 Queen Street, Suite 304
Honolulu, Hawaiʻi 96813
Telephone: (808) 536-4587
Facsimile: (808) 536-4588
E-mail: tom@tfhawaii.org

Attorney for Plaintiff

Electronically Filed
FIRST CIRCUIT
1CCV-24-0000661
20-MAY-2024
01:39 PM
Dkt. 1 CMP

IN THE CIRCUIT COURT OF THE FIRST CIRCUIT

STATE OF HAWAIʻI

In re DEPARTMENT OF TAXATION, ADMINISTRATIVE DIRECTIVE NO. 2021-01. TAX FOUNDATION OF HAWAIʻI, a Hawaiʻi nonprofit corporation, Plaintiff, vs. DEPARTMENT OF TAXATION, STATE OF HAWAIʻI, Defendant.	CASE NO. _____ COMPLAINT FOR DECLARATORY JUDGMENT; EXHIBIT 1; SUMMONS (Other Civil Action)

COMPLAINT FOR DECLARATORY JUDGMENT

Plaintiff TAX FOUNDATION OF HAWAIʻI, for its Complaint against Defendant DEPARTMENT OF TAXATION, STATE OF HAWAIʻI (Department), alleges as follows.

1. This action seeks to expose "secret law" that the respondent agency has made outside of public view and to invalidate it for failure to follow

I do hereby certify that the foregoing is a full, true and correct copy of the official court record of the Courts of the State of Hawai`i.
Dated at: Honolulu, Hawai`i 20-MAY-2024, /s/ Lori Ann Okita, Clerk of the First Judicial Circuit, State of Hawai`i

the requirements of the statutory provisions that the agency purports to enforce, and for failure to follow the requirements of the Hawaii Administrative Procedure Act, chapter 91, HRS.

PARTIES

2. Plaintiff TAX FOUNDATION OF HAWAIʻI ("Plaintiff") is a Hawaiʻi nonprofit corporation with its only office in the City and County of Honolulu, State of Hawaiʻi. The Supreme Court of Hawaiʻi has recognized Plaintiff "based on its historical purpose as a governmental financial accountability watchdog." *Tax Foundation of Hawaiʻi v. State,* 144 Hawaiʻi 175, 202-03, 439 P.3d 127, 154-55 (2019).

3. Defendant DEPARTMENT OF TAXATION, STATE OF HAWAIʻI is the government agency of the State of Hawaiʻi charged with enforcing the State's tax laws.

JURISDICTION AND VENUE

4. This Court has jurisdiction over this claim for declaratory relief under HRS § 91-7 and HRS § 632-1.

5. Venue is proper in this Court under HRS § 91-7(a) because the Plaintiff's principal place of business is in this Circuit.

6. Venue is proper in this Court under HRS § 603-36(5) because the prohibited acts occurred and the claim for relief arose in this Circuit.

FACTUAL BACKGROUND

7. On or around April 27, 2021, the Department issued Administrative Directive 2021-01 (hereinafter AD 2021-01). The Department

disseminated AD 2021-01 as a "For Internal Use Only" document to and for use by the Department's employees. A copy of AD 2021-01 is attached as Exhibit 1 hereto.

8. AD 2021-01 was not published on the Department's website or otherwise disclosed to the public. However, on or about May 4, 2024, the Department produced AD 2021-01 to the Foundation in response to a request under the Uniform Information Practices Act, chapter 92F, HRS.

9. In AD 2021-01, the Department set forth nonpublic guidance relating to HRS § 231-39(b)(2)(A) (hereinafter the Negligence Penalty), wherein a penalty is imposed on an underpayment of tax that is due to negligence or intentional disregard of rules but without intent to defraud.

10. AD 2021-01 states that the following circumstance, among others, constitutes negligence or disregard of rules or regulations for purposes of the Negligence Penalty:

- A taxpayer fails to respond to auditor/examiner's audit requests, in a timely manner. A failure to respond to a second request within ten business day will be deemed negligent. If taxpayer later responds and can show that the non-filed return was not due to negligence or intentional disregard of rules, the penalty may be removed.

11. For ease of reference, the provision quoted in the preceding paragraph will be referred to as the Failure to Respond Condition.

12. The Negligence Penalty is imposed when a position on a taxpayer's tax return, or lack thereof, results in underpayment of tax and the underpayment is due to negligence or intentional disregard of rules. Because the Failure to Respond Condition can occur only when a taxpayer's return is

being examined or audited, or when the taxpayer has not filed a required return, the Failure to Respond Condition has, and can have, nothing to do with whether the Negligence Penalty may be imposed.

13. Because the Failure to Respond Condition is unrelated to the Negligence Penalty, the Department's direction in AD 2021-01 that the Negligence Penalty is to be imposed when the Failure to Respond condition is met is an improper and unlawful interpretation of the Negligence Penalty.

14. AD 2021-01 also sets forth a list of four other circumstances which, alone or in combination, constitute negligence or disregard of rules or regulations for purposes of the Negligence Penalty.

15. These four other circumstances (hereinafter "Four Other Circumstances") have not been made known to the public or to tax practitioners except to the extent they merely repeat existing statutes.

COUNT 1

VIOLATION OF HAWAIʻI ADMINISTRATIVE PROCEDURE ACT

16. HRS § 91-1 defines a "rule" for purposes of chapter 91, HRS, as "each agency statement of general or particular applicability and future effect that implements, interprets, or prescribes law or policy, or describes the organization, procedure, or practice requirements of any agency. The term does not include regulations concerning only the internal management of an agency and not affecting private rights of or procedures available to the public, nor does the term include declaratory rulings issued pursuant to section 91-8, nor intra-agency memoranda."

17. The Failure to Respond Condition, which is not simply a guideline for internal case management but which affects the substantial rights of taxpayers, is a rule within the meaning of HRS § 91-1.

18. The Failure to Respond Condition goes beyond, and is inconsistent with, the Negligence Penalty statute that it purports to interpret.

19. The Failure to Respond Condition, therefore, exceeds the statutory authority of the Department.

20. The Failure to Respond Condition was adopted without compliance with rulemaking procedures set forth in chapter 91, HRS.

21. The Foundation, consistently with its historical purpose as a governmental financial accountability watchdog, is an interested party with respect to any rules (as defined in HRS § 91-1) that are contained within AD 2021-01.

22. For these reasons, the Failure to Respond Condition must be declared invalid pursuant to HRS § 91-7(b).

23. The Four Other Circumstances, which also affect the substantial rights of taxpayers, are also rules within the meaning of HRS § 91-1.

24. The Four Other Circumstances were adopted without adherence to rulemaking procedures set forth in chapter 91, HRS.

25. For these reasons, the Four Other Circumstances must be declared invalid pursuant to HRS § 91-7(b).

COUNT 2

DECLARATORY JUDGMENT

26. AD 2021-01, as a direction to the Department's staff including auditors and examiners, was and is affecting the rights of taxpayers generally and the Foundation's constituencies in particular.

27. AD 2021-01's linkage of the Failure to Respond Condition and the Negligence Penalty is unsupported by any of the statutes the Department has jurisdiction to interpret.

28. For these reasons, the Foundation is entitled to a declaratory judgment stating that the Failure to Respond Condition is not a valid interpretation of the Negligence Penalty and that the Department's instructions to its staff linking the Failure to Respond Condition to the Negligence Penalty are unlawful and should not be given effect.

DEMAND FOR RELIEF

WHEREFORE, Plaintiff prays for relief from this Court as follows:

1. For an order declaring that the Failure to Respond Condition and the Four Other Circumstances are invalid rules.

2. For an order declaring that the Failure to Respond Condition cannot be validly linked to the Negligence Penalty.

3. For costs of suit and reasonable attorneys' fees.

4. For such other and further relief as this Court deems proper.

DATED: Honolulu, Hawai‘i, May 20, 2024.

/s/ Thomas Yamachika

THOMAS YAMACHIKA
Attorney for Plaintiff
TAX FOUNDATION OF HAWAI‘I