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

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IN THE CIRCUIT COURT OF THE FIRST CIRCUIT

STATE OF HAWAII

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. 1CCV-24-0000661 REPLY MEMORANDUM IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT; DECLARATION OF THOMAS YAMACHIKA; EXHIBIT 1 and CERTIFICATE OF SERVICE HEARING DATE AND TIME: July 16, 2024, 2:00 p.m. HONORABLE KARIN L. HOLMA No trial date set

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REPLY MEMORANDUM IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT

I. DISCUSSION

Plaintiff Tax Foundation of Hawai'i (the "Foundation"), at the outset, would like to make its position clear. The Foundation has no interest in restraining or impeding the lawful functions of Defendant Department of Taxation ("Department"). But the Foundation, and its constituents, does have an interest in making sure that the Department's functions ***are*** lawful, and that it is administering Hawaii's tax laws without feeding its staff toxic disinformation. Moreover, the Hawaii Administrative Procedures Act (HAPA), chapter 91, HRS, has manifested a distaste for "secret law," known to administrative insiders but not to the hapless taxpaying public, and has mandated that general policy statements need to be out in the open, and formulated with the benefit of public input, for their validity to be respected.

A. This Case Does Not Fall Within the Jurisdiction of the Tax Appeal Court and Is Not Barred by HRS § 632-1.

Although the Tax Appeal Court is a court of record, HRS § 232-11, its jurisdiction is limited. It can only determine "the amount of valuation or taxes, as the case may be, in dispute" as between the taxing agency and the taxpayer assessed. HRS § 232-13. Thus, if there is no dispute about any particular taxpayer's tax liability, which is the case here, then the Foundation cannot bring its claim before the Tax Appeal Court. *Tax Foundation of Hawai'i v. State,* 144 Haw. 175, 186, 439 P.3d 127, 138 (2019). Rather, a HAPA suit is proper in the circuit court where the petitioner resides or has its principal place of business. HRS § 91-7(a).

With respect to HRS § 632-1, the law does say "declaratory relief may not be obtained … in any controversy with respect to taxes," but then follows that sentence with: "Controversies involving the interpretation of deeds, wills, other instruments of writing, statutes, municipal ordinances, and other governmental regulations, may be so determined, …." (Emphasis added.) This case involves the interpretation and validity of AD 2021-01, which is a written instrument and/or an "other governmental regulation[]," and thus is within the exception to the statutory proviso barring a determination with respect to taxes.

B. No Elaborate Factual Foundation Is Needed to Establish the Invalidity of the Failure to Respond Condition and the Four Other Circumstances.

The Department complains about four alleged factual deficiencies. In no case are the alleged deficiencies material and the facts can be gleaned simply from the tenor of AD 2021-01 itself.

First, the Department complains that there is no evidence in the record that the Director of Taxation issued "orders" by way of the Administrative Directive. The document itself, however, bears the signature of the Director of Taxation. The word "directive" means "An order or instruction, especially one issued by an authority." American Heritage Dictionary (5th ed. 2016). The document itself ***is*** an order.

Second, the Department complains that there is no evidence in the record that the Director of Taxation caused the Administrative Directive to be disseminated to Department employees. The document itself is on official letterhead, is marked "For Internal Use Only," and is serially numbered by

year—unusual steps if the document is actually to be read by no one else. Moreover, the definition of "rule" in HAPA, namely HRS § 91-1, only requires that a rule be a "statement of general or particular applicability and future effect that implements, interprets, or prescribes law or policy." It does not have to be published. Publication is not a material fact.

Third, the Department complains that there is no evidence in the record that the Administrative Directive was not disseminated to the public, was not published on the Department's website, or otherwise disclosed to the public. But the document itself is labeled "For internal use only," which is evidence of non-publication.

Fourth, the Department complains that the Foundation fails to demonstrate that AD 2021-01 was ever used to impose a negligence penalty. That misses the point. Interested persons are allowed to bring declaratory judgment suits, either under the Administrative Procedure Act or under the Declaratory Judgment Act, ***without needing a victim***. HRS § 632-6 explains why:

> This chapter is declared to be remedial. Its purpose is to afford relief from the uncertainty and insecurity attendant upon controversies over legal rights, without requiring one of the parties interested so to invade the rights asserted by the other as to entitle the party to maintain an ordinary action therefor. It is to be liberally interpreted and administered, with a view to making the courts more serviceable to the people.

Finally, the substantive argument that the Department offers in support of the provision, that "the Department would be precluded from considering *any* factors after a return is filed including the Department's discovery of facts during the audit, that occurred after taxpayer's returns were filed, which

demonstrate that taxpayer was in indeed negligent in not making a timely payment," Memo. in Opposition at 7, is just wrong. Of course, the Department is free to find facts, documents, or other evidence indicating that a taxpayer's ***position taken on its return,*** or ***failure to file a return,*** was negligent. It is what the taxpayer put on the return, or the taxpayer's failure to file a return, that causes the tax deficiency and is the conduct that can be penalized. The Failure to Respond Condition is entirely separate. Suppose a motorist is pulled over for recklessly making a left turn. The motorist, when approached by the arresting offer, doesn't want to show the officer his driver's license. Is the failure to show the driver's license relevant to whether the motorist ***made the left turn recklessly?*** Obviously not. That is what *Masterson v. Commissioner,* T.C. Memo. 1981-681, stands for. A copy of the case is included for the Court's convenience as Exhibit 1.

And finally, the Department points out, correctly, that the Department is not required to promulgate rules when assessing taxes or imposing penalties. The problem here, however, is that the Department produced AD 2021-01, which document purports to instruct Department staff on how to apply the Negligence Penalty when at least some of the instructions are unlawful, and none of them have been exposed to public notice and comment. HAPA says that such documents are invalid, and the Foundation seeks a judgment so holding.

C. The Foundation Has Standing Under HRS § 632-1 and As an Interested Person Under HRS § 91-7.

Antagonistic claims exist between the Foundation and the Department as to whether the Negligence Penalty can be applied to post-return conduct as envisioned in the Failure to Respond Condition. Under the Foundation's purpose as a governmental financial accountability watchdog, the Foundation has an interest in a right to have the Negligence Penalty applied when, and only when, the statutory conditions for it are satisfied, which right is denied by the Department, which apparently claims the right to impose the Negligence Penalty when its auditors are inconvenienced by taxpayers unable to cough up documents within the time frames dictated by said auditors. A judgment of this Court will terminate the uncertainty. Thus, the Foundation has HRS § 632-1 standing. *Tax Foundation,* 144 Haw. at 202-03, 439 P.3d at 154-55.

Furthermore, as pointed out in its moving papers, the Foundation is an interested person "in cases in which the rights of the public might otherwise be denied hearing in a judicial form." A*sato v. Procurement Policy Board,* 132 Haw. 333, 344, 322 P.3d 228, 239 (2014) (quoting *Pele Defense Fund v. Paty,* 73 Haw. 578, 593, 837 P.2d 1247, 1257 (1992).

The Foundation does understand that a tax appeal, where the tax liability of a taxpayer is being adjudicated, belongs in the Tax Appeal Court or Board of Review and is not within the province of the Circuit Courts. This is not such a case. The Foundation, moreover, is not challenging the authority of the Department to impose penalties, the Negligence Penalty included, when the statutes say it is proper to do so. The Foundation is, however, upset at

palpably false information being given to Department employees in secret to use when meting out consequences to the taxpaying public.

II. CONCLUSION

In this case the Foundation has managed to expose a document from the Department embodying "secret law" that turns out to contain misinformation. To uphold the Legislature's intent behind the actual law, HAPA and the Declaratory Judgment Act allow for nonpublic disinformation to be invalidated by the Judiciary. For these reasons the Foundation respectfully urges that its Motion be granted.

DATED: Honolulu, Hawaii, July 5, 2024.

/s/ Thomas Yamachika
THOMAS YAMACHIKA
Attorney for Plaintiff
Tax Foundation of Hawai'i

IN THE CIRCUIT COURT OF THE FIRST CIRCUIT

STATE OF HAWAII

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. 1CCV-24-0000661 DECLARATION OF THOMAS YAMACHIKA

DECLARATION OF THOMAS YAMACHIKA

THOMAS YAMACHIKA states:

1. I am an attorney licensed to practice in Hawaii. I am the president of and represent the TAX FOUNDATION OF HAWAIʻI. I make this Declaration of my own knowledge.

2. Attached as Exhibit 1 is a copy of a Memorandum Opinion of the United States Tax Court captioned Thomas J. Masterson, T.C. Memo. 1981-681.

I declare, under penalty of perjury, that the foregoing is true and correct.

DATED: Honolulu, Hawaii, July 5, 2024.

/s/ Thomas Yamachika
THOMAS YAMACHIKA

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing document will be served on the following counsel through JEFS on the date hereof.

ANNE E. LOPEZ, Attorney General
NATHAN S.C. CHEE and
JANINE R. UDUI, Deputy Attorneys General
425 Queen Street
Honolulu, Hawaii 96813

Attorneys for
DEPARTMENT OF TAXATION, STATE OF HAWAII

DATED: Honolulu, Hawaii, July 5, 2024.

/s/ Thomas Yamachika
THOMAS YAMACHIKA
Attorney for Plaintiff
Tax Foundation of Hawaiʻi