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# Exhibit 1

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FIRST CIRCUIT
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23-OCT-2024
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# Exhibit 1

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 23-OCT-2024, /s/ Lori Ann Okita, Clerk of the First Judicial Circuit, State of Hawai`i

DAVID Y. IGE
GOVERNOR

JOSH GREEN, M.D.
LT. GOVERNOR

ISAAC W. CHOY
DIRECTOR OF TAXATION

STATE OF HAWAII

DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1500

FOR INTERNAL USE ONLY

ADMINISTRATIVE DIRECTIVE
NO. 2021-01
DATE: April 27, 2021

DEPARTMENT OF TAXATION
OFFICE OF THE DIRECTOR

Assessment of Penalties

The purpose of this Administrative Directive is to assess all applicable penalties under Title 14, Hawaii Revised Statutes (HRS). In furtherance of penalty assessments, the following guidance and delegation are confirmed:

- Tax Audit Guideline 2009-01: Hawaii Civic Tax Penalty Matrix dated October 26, 2009
- Delegation of Authority No. 2015-01 dated March 11, 2015
- Compliance Division Memo 2021-01: Application of E-filing Penalty on Assessments

Additional guidance is hereby given on the Failure to Pay Tax Due to Negligence Penalty under HRS §231-39(b)(2)(A):

> If any part of any underpayment is due to negligence or intentional disregard of rules (but without intent to defraud), there shall be added to the tax an amount up to twenty-five per cent of the underpayment as determined by the director.

This penalty shall be applied to both filed and non-filed periods as in prior administrations. Negligence or disregard of rules or regulations include, but are not limited to, the following circumstances:

- A taxpayer fails to make a reasonable attempt to ascertain the correctness of a deduction, credit or exclusion on a return which would seem to a reasonable and prudent person to be "too good to be true" or unreasonable under the circumstances.
- A taxpayer carelessly, recklessly, or intentionally disregards Hawaii tax rules and regulations.
- A taxpayer visibly passed on tax to a customer but has not filed a return or remitted the tax.
- A taxpayer previously filed tax returns but stopped filing.
- 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.

The long-standing use of common penalties is hereby also approved and confirmed:

| Penalty | HRS | Amount | Stackable | Needs Director Approval |
|---|---|---|---|---|
| Failure to File Tax Return | §231-39(b)(1) | 5% per month, up to 25% | Yes | No |
| Substantial Understatement or Misstatement of Tax | §231-36.6 | 20%; check threshold | Yes[1] | Yes, see delegation |
| Erroneous Refund Claims | §231-36.8 | 20%; check threshold | Yes[2] | Yes, see delegation |
| Failure to Pay Tax Due to Negligence | §231-39(b)(2)(A) | 25% | Yes | No |
| Failure to Pay Tax Due to Fraud | §231-39(b)(2)(B) | 50% | No | No |
| Understatement of Tax Liability by Tax Return Preparer | §231-36.5 | $500 or $1,000 | Yes | Yes |
| Promoting Abusive Tax Shelters | §231-36.7 | up to $1,000 | Yes | Yes |
| County Surcharge Non-Compliance Penalty | §237-8.6(g) | 10% | Yes | No |
| Mandatory Electronic Filing | §231-8.5 | 2%; check tax types and thresholds | Yes | No |
| Underpayment of Estimated Tax (UET) | §235-97(f) | 2/3 of 1% per month | Yes[3] | No |

ISAAC W. CHOY
Director of Taxation

Attachments:

Tax Audit Guideline 2009-01: Hawaii Civic Tax Penalty Matrix dated October 26, 2009
Delegation of Authority No. 2015-01 dated March 11, 2015
Compliance Division Memo 2021-01: Application of E-filing Penalty on Assessments

[1, 2] Substantial understatement under HRS §231-36.6 and erroneous claim for refund under HRS §231-36.8 are prohibited from being stacked together under Hawaii law.

[3] UET penalty can only be assessed on a non-filer and shall not be assessed when a return has been filed.

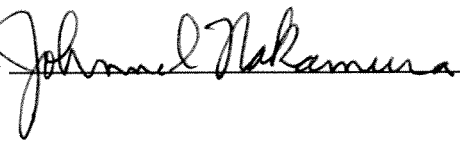
# Department of Taxation

TAX AUDIT GUIDELINE 2009-01

[redacted]

**TO:** COMPLIANCE DIVISION

**FROM:** RULES OFFICE

[Rules Officer Approval  ]

**RE:** HAWAII CIVIL TAX PENALTY MATRIX

**DATE:** OCTOBER 26, 2009

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The purpose of this document is to provide Compliance Division personnel with an analytical matrix of the various civil penalties assessable under Title 14, Hawaii Revised Statutes. These penalties are specifically discussed because they require the Auditor's discretion and judgment in assessment. This document serves as a high level "issue spotting" tool that may be utilized when considering whether a penalty is appropriate for a particular case.

This analytical guideline is for internal use only, is intended to be a reference tool, and is not authoritative. Relevant Hawaii and federal statutes, administrative rules and regulations, case law, and formal Department of Taxation positions (TIRs) will control over this document.

**Civil Penalty Checklist In Order of Relevant Consideration**

- ☐ Failure to File Tax Return
- ☐ Substantial Understatement or Misstatement of Tax
- ☐ Erroneous Refund Claim
- ☐ Negligence
- ☐ Fraud
- ☐ Understatement of Tax Liability by Tax Return Preparer (assessed against preparer)
- ☐ Promoting Abusive Tax Shelter (assessed against promoter)

**Failure to File Tax Return—HRS § 231-39(b)(1)**

- Imposes a penalty equal to 5% of the amount of tax required to be shown on the return per month, not to exceed 25% of the amount of tax, for failing to file a tax return required by law.
- Extensions to file are taken into account in determining whether a return is filed timely. Therefore, where an extension is filed, the deadline for purposes of the penalty is extended.
- Penalty does not apply to failure to file declarations of estimated tax under HRS § 235-97.
- Penalty may be remitted if failure to file is due to "reasonable cause and not due to neglect."
- An erroneous belief that no tax liability was due or owing is not "reasonable cause." *In re Grayco Land & Escrow*, 57 Haw. 436.
- "'Reasonable cause' has been interpreted to mean no more than the exercise of ordinary business care and prudence. However, a mere showing of absence of willful neglect is insufficient to avoid the penalty.****It is generally recognized that the presence of certain factors, in addition to the honest belief of the taxpayer, constitutes reasonable cause for the failure to file a return, *e.g.*, the advice of a competent accountant or attorney." *In re Grayco Land & Escrow*, 57 Haw. 436.

**Substantial Understatement or Misstatement of Tax—HRS § 231-36.6**

- Imposes a penalty equal to 20% of the portion of an underpayment attributable to an understatement of tax.
- There is an understatement of tax for a taxable year where the understatement exceeds the greater of 10% of the tax required to be shown on the return; or $1,500 ($30,000 for C Corps).
- Understatement amount is reduced by portions attributable to positions with substantial authority or where adequately disclosed and there is a reasonable basis.
- "Understatement" means the excess of the amount of tax required to be shown on the return over the amount of tax shown on the return.
- This penalty is in addition to any other penalty assessable.
- The Director must approve assessment of this penalty.

**Erroneous Refund Claims—HRS § 231-36.8**

- Imposes a penalty equal to 20% of the excessive amount associated with erroneous claims for refund or credit.
- "Excessive amount" means the amount by which the amount of refund or credit claimed exceeds the amount of credit or refund allowable.
- No penalty is assessable where the penalty is less than $400. Therefore, there can be no penalty where the excessive amount is less than $2,000. Temp. HAR § 18-231-36.8-01-6676T(e).
- No penalty is assessable where there is a reasonable basis for the claim.
- "Reasonable basis" means a standard of care that is not frivolous or patently improper. The position must be more than arguable and have at least one or more supporting authorities. Such a position is one where a person knowledgeable in tax law would lead the person that the position has a 1-in-4 chance (25%) of success on the merits.

Reasonable basis includes innocent mistakes and inadvertent math errors. There is no reasonable basis where a person knows the position or claim will not qualify.

- The burden of proof is on the taxpayer.
- The Director must approve assessment of this penalty.

**Failure to Pay Tax Due to Negligence—HRS § 231-39(b)(2)(A)**

- Imposes a penalty of up to 25% of an underpayment due to negligence or intentional disregard of rules (but without intent to defraud).
- "The term 'negligence' includes any failure to make a reasonable attempt to comply with the provisions of the [tax] laws or to exercise ordinary and reasonable care in the preparation of a tax return. 'Negligence' also includes any failure by the taxpayer to keep adequate books and records or to substantiate items properly." Treas. Reg. § 1.6662-3(b)(1).
- "The term 'disregard' includes any careless, reckless or intentional disregard of rules or regulations****A disregard of rules or regulations is 'careless' if the taxpayer does not exercise reasonable diligence to determine the correctness of a return position that is contrary to the rule or regulation. A disregard is 'reckless' if the taxpayer makes little or no effort to determine whether a rule or regulation exists, under circumstances which demonstrate a substantial deviation from the standard of conduct that a reasonable person would observe. A disregard is 'intentional' if the taxpayer knows of the rule or regulation that is disregarded." Treas. Reg. § 1.6662-3(b)(2).
- There is no reasonable cause exception to this penalty.
- Burden of proof is on the taxpayer.

**Failure to Pay Tax Due to Fraud—HRS § 231-39(b)(2)(B)**

- Imposes a penalty of up to 50% of an underpayment required to be shown on a return due to fraud. If a fraud penalty is assessed, there can be no civil penalty for failure to file.
- Whether fraud exists depends upon the facts of each case. Unless admitted by the taxpayer, fraud is typically proven circumstantially by demonstrated "badges of fraud."
- A fraud penalty would be appropriate where an underpayment is due to falsity, evasion, concealment, or other similar facts.
- Burden of proof is on the government to show fraud.
- There is no reasonable cause exception to this penalty.
- Filing amended returns to correct fraudulent original returns does not preclude assessing the fraud penalty on original returns. *Frank v. Comm.*, 13 TC 253 (1949).

**Understatement of Tax Liability by Tax Return Preparer—HRS § 231-36.5**

- Generally, imposes a $500 penalty on a tax return preparer who understates a person's tax liability by taking an unreasonable position.
- Imposes a $1,000 penalty on a tax return preparer who willfully understates a person's tax liability or recklessly disregards any tax law or rule in understating a person's tax liability based upon an unreasonable position.
- Penalties apply per return prepared.
- An understatement due to an unreasonable position occurs when:
    - Any part of a return or claim is based on a position that does not have substantial authority;

    - The tax return preparer knew or should have known of the unreasonable position; and
    - The position was not disclosed or was frivolous.
- A position is disclosed where there is an attachment of an analysis of the position and there was a reasonable basis for the position.
- "Substantial authority" means statutes, rules, rulings, announcements, TIRs, committee reports, etc.
- "Tax return preparer" is broad and includes persons beyond those signing the return.
- "The tax return preparer is not required to audit, examine or review books and records, business operations, documents, or other evidence to verify independently information provided by the taxpayer, advisor, other tax return preparer, or other party. The tax return preparer, however, may not ignore the implications of information furnished to the tax return preparer or actually known by the tax return preparer. The tax return preparer must make reasonable inquiries if the information as furnished appears to be incorrect or incomplete." Temp. HAR § 18-231-36.5-01-6694T(a)(1).
- The Director must approve assessment of this penalty.
- Tax preparers have appeal rights pursuant to HRS § 231-36.5 independent of the audit of the tax return at issue. See Rules Office for procedural guidance on issuing this penalty and preparer's appeal rights.
- A tax preparer may be enjoined for certain prohibited acts. Injunctions are handled by the AG after referral from the Department.

**Promoting Abusive Tax Shelters—HRS § 231-36.7**

- Imposes a penalty of $1,000 or the amount of gross income received, whichever is less, for the promotion of an abusive tax shelter. Each act of promoting a tax shelter constitutes a separate violation.
- A person "promotes an abusive tax shelter" by:
    - Organizing or assisting in the organization, or participating in the sale of an interest in an entity or other plan or arrangement; and
    - In connection with such activity, a statement is made or a person is caused to make a statement respecting whether a deduction or credit is allowed, income may be excluded, or other tax benefit may be secured;

  that the person promoting knows or has reason to know is false or fraudulent or is a gross valuation overstatement.
- Penalty may be remitted with respect to a gross valuation overstatement if there was a reasonable basis and the valuation was made in good faith.
- "Gross valuation misstatement" means a statement of value for property or services where the value stated exceeds 200% of the correct value and the value is directly related to an amount of credit or deduction allowable.
- A safe harbor from this penalty is available where a tax shelter promoter obtains a favorable ruling from the Department. Temp. HAR § 18-231-36.7-01-6700T(d).
- This penalty is in addition to any other penalty assessable.
- The Director must approve assessment of this penalty.
- See Rules Office for procedural guidance on issuing this penalty and preparer's appeal rights.
- A promoter may be enjoined for certain prohibited acts. Injunctions are handled by the AG after referral from the Department.

DAVID Y. IGE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR

MARIA E. ZIELINSKI
DIRECTOR OF TAXATION

STATE OF HAWAII
**DEPARTMENT OF TAXATION**
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1540
FAX NO: (808) 587-1560

DELEGATION OF AUTHORITY

NO. 2015-01
Date: March 11, 2015
(Supersedes No. 2011-01)

DEPARTMENT OF TAXATION
OFFICE OF THE DIRECTOR

DELEGATION OF AUTHORITY TO APPROVE PENALTIES AND FINES AS REQUIRED UNDER §231-10.6, HRS

Section 231-10.6, Hawaii Revised Statutes, requires the approval of the Director before penalties and fines are assessed against a return preparer or taxpayer for understatement of tax liabilities, promotion of abusive tax shelters, erroneous claims for refund or credit, or substantial understatements or misstatements of tax.

The current procedure of the Field Audit Branch requires the auditor to send a memo to the Director through the Compliance Division Administrator, the Field Audit Branch Chief, and the Group Chief. Similarly, the current procedure of the District Offices requires the auditor to send a memo to the Director through the Compliance Division Administrator, the District Tax Manager, and the Supervisor. Since all proposed assessments are reviewed at two levels, adequate safeguards are in place to ensure the penalties are imposed according to the statutes.

To expedite the closing of audits and the issuance of assessments, the authority to approve the assessment of penalties of no more than $20,000 per assessment is delegated to the Field Audit Branch Chief, the Office Audit Branch Chief and the District Tax Managers.

MARIA E. ZIELINSKI
Director of Taxation

State of Hawaii

# DEPARTMENT OF TAXATION

Interoffice Memorandum

TO: Compliance All

THRU: Kevin Wakayama, Tax Compliance Administrator

FROM: Regina Yuen, Tax Compliance Coordinator

SUBJECT: Compliance Division Memo 2021-01
Application of E-filing Penalty on Assessments

DATE: February 25, 2021

This memo provides guidance on applying the e-filing penalty on assessments.

Act 66, Session Laws of Hawaii 2018, amended HRS §231-8.5, to enable the Department to require certain taxpayers, including general excise and transient accommodations taxpayers whose liability exceeds $4,000 for the taxable year, and corporate income tax return taxpayers to file returns electronically. The Department will impose a two percent penalty on the amount of tax required to be shown on the return if the return is not filed electronically unless failure is due to reasonable cause and not due to neglect.

The e-filing penalty should be assessed in the following situations:

- The 2% e-filing penalty was applied to taxpayer's filed return for the period.
- If taxpayer is a non-filer, e-filing penalty applies if taxpayer is required to file electronically.

If the assessment is made before due date of the return on a non-filer, the e-filing penalty should not be imposed.

The e-filing penalty can be assessed manually on an assessment by checking off the "eFile Penalty" box under non-interest bearing penalty and county surcharge (if applicable) in the penalties tab of audit worksheet.

General Excise (G-49), Transient Accommodations (TA-2) and Corporate Income Tax (N-30) are subject to e-filing penalty effective for taxable period beginning on or after January 1, 2020. Please refer to attached list for more information, include other tax types subject to the penalty and its effective date.

Electronic-filing (e-filing) requirements are different from electronic payment (e-pay) requirements.

Tax Types Required to E-file, with Effective Date

| Tax Return Type | Forms | Effective for Taxable Period beginning on or after | Tax Announcement (Notice required under section 231-8.5(c)(2), HRS) |
|---|---|---|---|
| Cigarette & Tobacco tax | • M-19<br>• M-110 | September 1, 2019 | Tax Announcement No. 2019-02 |
| Fuel tax | • M-20A<br>• M-22<br>• M-36 | September 1, 2019 | Tax Announcement No. 2019-02 |
| Liquor tax | • M-18 | September 1, 2019 | Tax Announcement No. 2019-02 |
| Rental motor vehicle, tour vehicle, and car sharing vehicle surcharge tax | • RV-2<br>• RV-3 | October 1, 2019 | Tax Announcement No. 2019-06 AMENDED |
| Corporate income tax returns | • N-30 | January 1, 2020 | Tax Announcement 2019-10 |
| Withholding tax returns for employers whose annual liability exceeds $40,000 (HW-3 is not required beginning Tax Year 2020.) | • HW-3<br>• HW-14<br>• HW-26 | January 1, 2020 | Tax Announcement 2019-11 AMENDED |
| Franchise tax | • F-1 | January 1, 2020 | Tax Announcement 2019-12 AMENDED |
| Public service company tax | • U-6 | January 1, 2020 | Tax Announcement 2019-13 AMENDED |
| Estate and generation-skipping transfer tax | • M-6 | January 1, 2020 | Tax Announcement 2019-14 AMENDED |
| General excise tax returns for taxpayers whose annual liability exceeds $4,000 | • G-45<br>• G-49 | July 1, 2020 for periodic returns<br>January 1, 2020 for annual returns | Tax Announcement 2019-16 |
| Transient accommodations tax returns for taxpayers whose annual liability exceeds $4,000 | • TA-1<br>• TA-2 | July 1, 2020 for periodic returns<br>January 1, 2020 for annual returns | Tax Announcement 2019-17 |

Additional tax type with mandatory e-filing requirements will be added in the future.

# Exhibit 2

# REQUEST TO ACCESS A GOVERNMENT RECORD

This is a model form that may be used by a Requester to provide sufficient information for an agency to process a record request. Although the Requester is not required to use this form or to provide any personal information, the agency needs enough information to contact the Requester with questions about this request or to provide its response. This request may not be processed if the agency has insufficient information or is unable to contact the Requester.

**DATE**: May 18, 2023

**TO**: Department of Taxation
**Agency that Maintains the Government Record**

**Public Information Officer, Tax.PIO@hawaii.gov**
**Agency's Contact Information**

**FROM**: Thomas Yamachika, Tax Foundation of Hawaii
**Requester's Name or Alias**

126 Queen Street, Suite 305, Honolulu, HI 96813, phone (808) 536-4587, tom@tfhawaii.org
**Requester's Contact Information**

_____

**AS THE REQUESTER, I WOULD LIKE THE FOLLOWING GOVERNMENT RECORD**:

Describe the government record as specifically as possible so that it can be located. Try to provide a record name, subject matter, date, location, purpose, or names of persons to whom the record refers, or other information that could help the agency identify the record. A complete and accurate description of the requested government record will prevent delays in locating the record. Attach additional pages if needed.

**All Administrative Directives issued by the Department of Taxation. These records are referred to on page 56 of the Annual Report (2021-22) of the Department of Taxation.**

**I WOULD LIKE:** (Please check one or more of the options below, as applicable)

☐ **To inspect the government record**

☒ **A copy of the government record: (**Please check only one of the options below.) See the next page for information about fees and costs that you may be required to pay for agency services to process your record request. Note: Copying and transmission charges may also apply to certain options.

- ☐ Pick up at agency (**date and time**): _____
- ☐ Mail (address): _____
- ☒ E-mail (address): tom@tfhawaii.org
- ☐ Fax (toll free and only if available; provide fax number): _____
- ☐ Other, if available (please specify): _____

☐ If the agency maintains the records in a form other than paper, please advise in which **format you would prefer to have the record**.

☐ Electronic ☐ Audio ☐ Other (please specify):_____

☒ Check this box **if you are attaching a request for waiver of fees in the public interest** (See waiver information on next page).

## FEES FOR PROCESSING PUBLIC RECORD REQUESTS

You may be charged fees for the services that the agency must perform when processing your request for public records, including fees for making photocopies and other lawful fees. **The first $30 of fees charged for searching for a record, reviewing, and segregating will not be charged to you. Any amount over $30 will be charged to you.** Fees are as follows:

| | |
|---|---|
| Search for a Record | $2.50 for 15 minutes |
| Review and Segregation of a Record | $5.00 for 15 minutes |

Generally, no search, review, and segregation fees may be charged if you are making a request for personal records that are about you.

## WAIVER OF FEES IN THE PUBLIC INTEREST

As an alternative to the $30 fee waiver (not in addition to), the agency may waive the first $60 of fees for searching for, reviewing and segregating records when the waiver would serve the public interest. If you wish to apply for a waiver of fees in the public interest, you must attach to this request a statement of facts, including your identity as the requester, to show how the waiver of fees would serve the public interest. The criteria for this waiver, found at section 2-71-32, Hawaii Administrative Rules, are

(1) The requested record pertains to the operations or activities of an agency;
(2) The record is not readily available in the public domain; and
(3) The requester has the primary intention and the actual ability to widely disseminate information from the government record to the public at large.

## COSTS

The Agency may charge you any other lawful fees and the costs to copy and deliver your personal or public record request.

## AGENCY RESPONSE TO YOUR REQUEST FOR ACCESS

The agency to which you addressed your request must respond within a set time period. The agency will normally respond to you within 10 business days from the date it receives your request; however, in ***extenuating circumstances,*** the agency must respond within 20 business days from the date of your request. If you have questions about the response time or the records being sought, you should first contact the agency and request to consult with the agency's UIPA contact person.

**Please note that the Office of Information Practices (OIP) does not maintain the records of other agencies and a requester must seek records directly from the agency**. If the agency denies or fails to respond to your written request for records or if you have other questions regarding compliance with the UIPA, then you may contact OIP at 808-586-1400, oip@hawaii.gov, or 250 South Hotel Street, Suite 107, Honolulu, Hawaii 96813.

## REQUESTER'S RESPONSIBILITIES

You have certain responsibilities under section 2-71-16, Hawaii Administrative Rules, which include making arrangements to inspect and copy records, providing further clarification or description of the requested record as instructed by the agency's notice, and making a prepayment of fees and costs, if assessed. The rules and additional training materials are available online at **oip.hawaii.gov** or from OIP.

STATEMENT SUPPORTING REQUESTED WAIVER OF FEES IN THE PUBLIC INTEREST

During a recent discussion with Department of Taxation personnel, Administrative Directives were identified as statements of policy internal to the agency that are followed by agency personnel. During the conversation, one was identified as containing criteria for agency personnel to grant or deny penalty waivers. The Foundation believes that these statements govern the operations of the Department. The Directives presently are not published on the Department's website.

The Tax Foundation of Hawaii has been recognized as having a "historical purpose as a governmental financial accountability watchdog." *Tax Foundation of Hawaii v. State,* 439 P.3d 127, 155 (Haw. 2019). The Foundation believes that these statements have great significance to taxpayers and tax preparers, and is fully prepared to publish them on its own website and to make them available to tax professionals through trade associations such as the Hawaii State Bar Association and the Hawaii Society of Certified Public Accountants.

# Exhibit 3

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
23-OCT-2024
10:23 AM
Dkt. 64 STIP

IN THE CIRCUIT COURT OF THE FIRST CIRCUIT

STATE OF HAWAII

| | |
|---|---|
| In re<br><br>DEPARTMENT OF TAXATION, ADMINISTRATIVE DIRECTIVE NO. 2021-01.<br><br>TAX FOUNDATION OF HAWAIʻI, a Hawaiʻi nonprofit corporation,<br><br>Plaintiff,<br><br>vs.<br><br>DEPARTMENT OF TAXATION, STATE OF HAWAIʻI,<br><br>Defendant. | CASE NO. 1CCV-24-0000661<br><br>STIPULATION OF FACTS; EXHIBIT 1 and CERTIFICATE OF SERVICE<br><br>HONORABLE KARIN L. HOLMA<br><br>TRIAL: Week of Feb. 3, 2025 |

**STIPULATION OF FACTS**

IT IS HEREBY STIPULATED AND AGREED between the parties hereto that, for purposes of this action:

1. Exhibit 1 hereto is a true and correct copy of Department of Taxation Administrative Directive 2021-01 ("**AD 2021-01**").

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 23-OCT-2024, /s/ Lori Ann Okita, Clerk of the First Judicial Circuit, State of Hawai`i

2. AD 2021-01 was placed on the Department of Taxation's internal shared drive and accessible to employees of the Department of Taxation.

3. AD 2021-01 was not uploaded onto the Department's internet website or otherwise made readily accessible to the public.

4. AD 2021-01 has not been superseded or obsoleted, and currently remains in effect.

DATED: Honolulu, Hawaii, October 23, 2024.

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

/s/ Janine R. Udui
NATHAN S.C. CHEE
JANINE R. UDUI
Attorneys for Defendant
Department of Taxation, State of Hawai'i

IN THE CIRCUIT COURT OF THE FIRST CIRCUIT

STATE OF HAWAII

| | |
|---|---|
| In re<br><br>DEPARTMENT OF TAXATION, ADMINISTRATIVE DIRECTIVE NO. 2021-01.<br><br>TAX FOUNDATION OF HAWAIʻI, a Hawaiʻi nonprofit corporation,<br><br>Plaintiff,<br><br>vs.<br><br>DEPARTMENT OF TAXATION, STATE OF HAWAIʻI,<br><br>Defendant. | CASE NO. 1CCV-24-0000661<br><br>CERTIFICATE OF SERVICE |

**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, October 23, 2024.

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

# Exhibit 4

LinkedIn account.

Q Okay. Is what's written on this exhibit an accurate reflection of your work experience?

A Yes.

Q Okay. So let me ask you about your current position. So what is your current position with the Department of Taxation?

A My current position is Special Assistant to the Director of Taxation.

Q Okay. And what are your duties as Special Assistant?

A My duties vary. I'm -- I do a lot of communications work internally and externally. I do some litigation coordination. I also do other tasks that the director may -- may request of me. So it depends, but I also have some responsibility for emergency operations.

Q Okay. Do you have any other titles within the Department?

A Any other titles?

Q Yes.

A I don't have any other titles, but I am currently in a rule specialist position.

Q Okay. Are you familiar with the term Public Information Officer?

# Exhibit 5

So you have some familiarity with the class of documents that are called Administrative Directives?

A Yes.

Q Okay. Can you tell me what they are.

A Administrative Directives are policy pronouncements.

Q Is that all they are?

A I -- yes.

Q Okay. Are you familiar with the process of how they're drafted?

A Generally speaking, it depends on the purpose of the Administrative Directive.

Q Okay. So can you explain further what you mean by that. Can you give me an example of like one that you're -- okay. So there's more than one type of Administrative Directive?

A There's a -- there is various subject matter that would prompt an administrative director -- directive. And depending on what the purpose of the Administrative Directive, who it's directed to and what they're trying to accomplish, the process may vary.

Q Okay. Can you provide me examples of these purposes.

A Administrative Directives generally are for -- it could be a myriad of subjects, including something as simple as how to probably use a facsimile machine, or -- and/or it could be something, in terms of if the director's unavailable, who is responsible -- you know, who's the line of succession if the director's -- so whatever administrative policy or -- that wishes -- that the director wishes to provide to the department for guidance, that's what the Administrative Directive would be for.

Q So it's a policy statement that comes from the director and goes to the department?

MS. UDUI: That misstates the answer.

BY MR. YAMACHIKA

Q Well, Mr. Witness, can you clear it up. Is that what it is or...

A I'm sorry, what's the question?

MR. YAMACHIKA: Can you read it back.

(Record read.)

THE WITNESS: All I can respond is it's a directive that's issued by the director for guidance to the department on various subject matter.

BY MR. YAMACHIKA

Q Okay. Who reviews these draft Administrative Directives before they are finally executed?

# Exhibit 6

A Yeah, I don't know the exact time period. But, yes, there was a time when it was the directive number, and then the year.

Q So it would be like Administrative Directive 1-1980 or 2-1980, or whatever. I'm sorry. It would start with the number, and then be followed by the year?

A Correct. So let's say it was -- let's say 1970. Instead of the current where we use -- and it's only a two-digit designation for the year -- 70-01, during that time period you're talking about, it was 01-70.

Q Okay. Okay, great. And do you know where the originals of all of these Administrative Directives are stored?

A In the Rules office.

Q And there's a folder with all of them?

A There is.

Q How many are there in total? Do you have an approximate idea?

A I think it's about 145.

Q 145?

A Yes.

Q Do you know whether there are other classes of documents that are non-public but do contain policy

# Exhibit 7

DAVID Y. IGE
GOVERNOR

JOSH GREEN M.D.
LT. GOVERNOR

STATE OF HAWAI'I
**DEPARTMENT OF TAXATION**

LINDA CHU TAKAYAMA
DIRECTOR OF TAXATION

DAMIEN A. ELEFANTE
DEPUTY DIRECTOR

Electronically Filed
FIRST CIRCUIT
1CTX-20-0000106
10-DEC-2020
02:55 PM
Dkt. 2 EXH

ENERGYMAN LTD.
59-032 HOLAWA ST
HALEIWA HI 96712-9706

Date: June 10, 2019
Letter ID: L1519166976
Hawaii Tax ID: GE-085-075-5584-01R

# NOTICE OF FINAL ASSESSMENT OF GENERAL EXCISE AND/OR USE TAX

Important Notice: RESPONSE REQUIRED IMMEDIATELY

The adjustments shown on this Notice of Final Assessment has been made in accordance with the provisions of Hawaii Revised Statutes (HRS). Please review this Notice of Final Assessment carefully as it provides detailed information about the assessment and payment due. The total amount is now due and payable.

If you have a Power of Attorney (POA) representative for General Excise and/or Use Tax and the filing periods audited, a copy of this letter containing the information related to the impacted filing periods has also been mailed to the representative.

**What do you need to do?**
You must take action immediately:

- If you **agree** with this Notice of Final Assessment, please mail your payment with the Payment Voucher (bottom of page 3 of this letter) to the address printed on the voucher or use Hawaii Tax Online (hitax.hawaii.gov, "Make Payment" under Quick Links).
- If you **disagree** with this assessment, you may appeal in accordance with the Hawaii Taxpayer Bill of Rights (page 2 of this letter).

**What happens if you do not take action?**
If you do not take action immediately, additional interest will be assessed and the total amount due may be referred for further collection actions.

Thank you for your prompt attention to this matter.

DIRECTOR OF TAXATION
By:

Donald Kuriki
Tax Assessor I

**PREPARER:**
A. Velasco
OAHU Office Audit Branch
PO Box 259
Honolulu HI 96809-0259
Telephone: (808) 587-1770

NOTICE OF FINAL ASSESSMENT OF GENERAL EXCISE AND/OR USE TAX

# ASSESSMENT SUMMARY

**Tax Account No:** GE-085-075-5584-01R
**Letter ID:** L1519166976

**Taxpayer Name:** ENERGYMAN LTD.
**Address:** 59-032 HOLAWA ST
HALEIWA HI 96712-9706

**Proposed Assessment Mail Date:** May 9, 2019

**Final Assessment Mail Date:** June 10, 2019
**Preparer:** A. Velasco

This Notice of Final Assessment addresses the following tax filing period(s):

| Filing Period | Total Amount Due on Filing Period |
|---|---|
| Dec 31, 2014 | $ 6,570.57 |
| Dec 31, 2015 | $ 982.44 |
| Dec 31, 2016 | $ 38,329.51 |
| Dec 31, 2017 | $ 6,767.36 |
| **Total Amount Due** | **$ 52,649.88** |

Additional details regarding the filing period(s) above are provided in the pages following.

---

To pay the Total Amount Due:

- Mail a payment using the Payment Voucher below.
- Pay online at hitax.hawaii.gov (Under Quick Links, choose "Make Payment" and select Voucher Media #).

Cut carefully along this line to detach.

STATE OF HAWAII, DEPARTMENT OF TAXATION

## PAYMENT VOUCHER

Do not photocopy this voucher. Do not send multiple checks with this voucher.

**Audit Payment**
**Name:** ENERGYMAN LTD.
**ID Type:** Media Number (01)
**ID:** 11925537921
**Voucher Date:** Jun-10-2019
**Letter ID:** L1519166976

**Make check payable to:** Hawaii State Tax Collector
**Mail to:** PO Box 259 Honolulu, HI 96809-0259

**Amount Due:** 52,649.88

**Pay Online** at hitax.hawaii.gov

12319999 0005264988 01 00011925537921 00 12319999 020

NOTICE OF FINAL ASSESSMENT OF GENERAL EXCISE AND/OR USE TAX

# DETAILS FOR TAX FILING PERIOD

**Filing Period Beginning:** January 1, 2014
**Filing Period Ending:** December 31, 2014

**Tax Account No:** GE-085-075-5584-01R
**Letter ID:** L1519166976

**Proposed Assessment Mail Date:** May 9, 2019

**Final Assessment Mail Date:** June 10, 2019
**Preparer:** A. Velasco

**Taxpayer Name:** ENERGYMAN LTD.
**Address:** 59-032 HOLAWA ST
HALEIWA HI 96712-9706

Provided below is detailed information regarding this period's assessment. Following the reasons for the assessment, is the Audit Adjustment Summary which details the adjustments that were made and the resulting penalty, interest, and balance or credit due.

## Audit Assessment Reason(s):

The assessments/adjustments shown are made in accordance with the provisions of Chapter 237, Hawaii Revised Statutes (HRS). The information for this assessment was obtained from your Federal Tax Information and from your Hawaii S Corporation Income Tax Return.

Commissions Underreported Under Section 237-13(9), HRS.

County Surcharge Underreported Under section 237-8.6, HRS.

Form 1120S - Gross Receipts or Sales: $165,188.

As filed - $103,098.

Additional tax/difference - $62,090.

A 25% penalty is assessed under section 231-39(b)(1), HRS, for the failure to timely file the required return by the original or extended due date.

A 25% penalty is assessed under section 231-39(b)(2)(A), HRS, for the failure to pay the tax due to negligence or intentional disregard of the rules.

A 10% penalty is assessed under section 237-8.6(g), HRS, for the failure to file the schedule or the failure to correctly report the assignment of the general excise tax by taxation district on the schedule.

## Audit Adjustment(s) Summary:

| Description | As Filed | As Adjusted | Additional Taxable | Rate | Additional Tax |
|---|---|---|---|---|---|
| Commissions | $ 103,098.00 | $ 165,188.00 | $ 62,090.00 | 0.0400 | $ 2,483.60 |
| Oahu Surcharge | $ 103,098.00 | $ 165,188.00 | $ 62,090.00 | 0.0050 | $ 310.45 |

## Computation of Total Amount Due on this Period:

| | |
|---|---|
| Total Additional Tax | $ 2,794.05 |
| Failure to Timely File Penalty @ 25% | $ 698.50 |
| County Surcharge Penalty @ 10% | $ 743.35 |
| Other Penalty @ 25% | $ 698.51 |
| Non-Interest Bearing Penalty | $ 0.00 |
| Interest @ 8% to 6/20/2019 | $ 1,636.16 |
| Fees | $ 0.00 |
| **Assessment Amount Due** | **$ 6,570.57** |
| Refund(s), Payment(s) or Credit(s) on this Tax Filing Period | $ 0.00 |
| Pre-Assessment Liability | $ 0.00 |
| Interest on Pre-Assessment Liability | $ 0.00 |
| **Total Amount Due on this Tax Filing Period** | **$ 6,570.57** |

NOTICE OF FINAL ASSESSMENT OF GENERAL EXCISE AND/OR USE TAX

# DETAILS FOR TAX FILING PERIOD

**Filing Period Beginning:** January 1, 2015
**Filing Period Ending:** December 31, 2015

**Tax Account No:** GE-085-075-5584-01R
**Letter ID:** L1519166976

**Proposed Assessment Mail Date:** May 9, 2019

**Final Assessment Mail Date:** June 10, 2019
**Preparer:** A. Velasco

**Taxpayer Name:** ENERGYMAN LTD.
**Address:** 59-032 HOLAWA ST
HALEIWA HI 96712-9706

Provided below is detailed information regarding this period's assessment. Following the reasons for the assessment, is the Audit Adjustment Summary which details the adjustments that were made and the resulting penalty, interest, and balance or credit due.

## Audit Assessment Reason(s):

The assessments/adjustments shown are made in accordance with the provisions of Chapter 237, Hawaii Revised Statutes (HRS). The information for this assessment was obtained from your Federal Tax Information and from your Hawaii S Corporation Income Tax Return.

Commissions Underreported Under Section 237-13(9), HRS.

County Surcharge Underreported Under section 237-8.6, HRS.

Form 1120S - Gross Receipts or Sales: $94,975.

As filed - $90,721.

Additional tax/difference - $4,254.

A 25% penalty is assessed under section 231-39(b)(1), HRS, for the failure to timely file the required return by the original or extended due date.

A 25% penalty is assessed under section 231-39(b)(2)(A), HRS, for the failure to pay the tax due to negligence or intentional disregard of the rules.

A 10% penalty is assessed under section 237-8.6(g), HRS, for the failure to file the schedule or the failure to correctly report the assignment of the general excise tax by taxation district on the schedule.

## Audit Adjustment(s) Summary:

| Description | As Filed | As Adjusted | Additional Taxable | Rate | Additional Tax |
|---|---|---|---|---|---|
| Commissions | $ 90,721.00 | $ 94,975.00 | $ 4,254.00 | 0.0400 | $ 170.16 |
| Oahu Surcharge | $ 81,396.00 | $ 94,975.00 | $ 13,579.00 | 0.0050 | $ 67.90 |

## Computation of Total Amount Due on this Period:

| | |
|---|---|
| Total Additional Tax | $ 238.06 |
| Failure to Timely File Penalty @ 25% | $ 59.55 |
| County Surcharge Penalty @ 10% | $ 427.39 |
| Other Penalty @ 25% | $ 59.52 |
| Non-Interest Bearing Penalty | $ 0.00 |
| Interest @ 8% to 6/20/2019 | $ 197.92 |
| Fees | $ 0.00 |
| **Assessment Amount Due** | **$ 982.44** |
| Refund(s), Payment(s) or Credit(s) on this Tax Filing Period | $ 0.00 |
| Pre-Assessment Liability | $ 0.00 |
| Interest on Pre-Assessment Liability | $ 0.00 |
| **Total Amount Due on this Tax Filing Period** | **$ 982.44** |

NOTICE OF FINAL ASSESSMENT OF GENERAL EXCISE AND/OR USE TAX

# DETAILS FOR TAX FILING PERIOD

**Filing Period Beginning:** January 1, 2016
**Filing Period Ending:** December 31, 2016

**Tax Account No:** GE-085-075-5584-01R
**Letter ID:** L1519166976

**Proposed Assessment Mail Date:** May 9, 2019

**Final Assessment Mail Date:** June 10, 2019
**Preparer:** A. Velasco

**Taxpayer Name:** ENERGYMAN LTD.
**Address:** 59-032 HOLAWA ST
HALEIWA HI 96712-9706

Provided below is detailed information regarding this period's assessment. Following the reasons for the assessment, is the Audit Adjustment Summary which details the adjustments that were made and the resulting penalty, interest, and balance or credit due.

## Audit Assessment Reason(s):

The assessments/adjustments shown are made in accordance with the provisions of Chapter 237, Hawaii Revised Statutes (HRS). The information for this assessment was obtained from your Federal Tax Information and from your Hawaii S Corporation Income Tax Return.

Commissions Underreported Under Section 237-13(9), HRS.

County Surcharge Underreported Under section 237-8.6, HRS.

Form 1120S - Gross Receipts or Sales: $468,778.

As filed - $15,213.

Additional tax/difference - $453,565.

A 25% penalty is assessed under section 231-39(b)(1), HRS, for the failure to timely file the required return by the original or extended due date.

A 25% penalty is assessed under section 231-39(b)(2)(A), HRS, for the failure to pay the tax due to negligence or intentional disregard of the rules.

A 10% penalty is assessed under section 237-8.6(g), HRS, for the failure to file the schedule or the failure to correctly report the assignment of the general excise tax by taxation district on the schedule.

## Audit Adjustment(s) Summary:

| Description | As Filed | As Adjusted | Additional Taxable | Rate | Additional Tax |
|---|---|---|---|---|---|
| Commissions | $ 15,213.00 | $ 468,778.00 | $ 453,565.00 | 0.0400 | $ 18,142.60 |
| Oahu Surcharge | $ 15,213.00 | $ 468,778.00 | $ 453,565.00 | 0.0050 | $ 2,267.83 |

## Computation of Total Amount Due on this Period:

| | |
|---|---|
| Total Additional Tax | $ 20,410.43 |
| Failure to Timely File Penalty @ 25% | $ 5,102.60 |
| County Surcharge Penalty @ 10% | $ 2,109.50 |
| Other Penalty @ 25% | $ 5,102.61 |
| Non-Interest Bearing Penalty | $ 0.00 |
| Interest @ 8% to 6/20/2019 | $ 5,604.37 |
| Fees | $ 0.00 |
| **Assessment Amount Due** | **$ 38,329.51** |
| Refund(s), Payment(s) or Credit(s) on this Tax Filing Period | $ 0.00 |
| Pre-Assessment Liability | $ 0.00 |
| Interest on Pre-Assessment Liability | $ 0.00 |
| **Total Amount Due on this Tax Filing Period** | **$ 38,329.51** |

NOTICE OF FINAL ASSESSMENT OF GENERAL EXCISE AND/OR USE TAX

# DETAILS FOR TAX FILING PERIOD

**Filing Period Beginning:** January 1, 2017
**Filing Period Ending:** December 31, 2017

**Tax Account No:** GE-085-075-5584-01R
**Letter ID:** L1519166976

**Proposed Assessment Mail Date:** May 9, 2019

**Final Assessment Mail Date:** June 10, 2019
**Preparer:** A. Velasco

**Taxpayer Name:** ENERGYMAN LTD.
**Address:** 59-032 HOLAWA ST
HALEIWA HI 96712-9706

Provided below is detailed information regarding this period's assessment. Following the reasons for the assessment, is the Audit Adjustment Summary which details the adjustments that were made and the resulting penalty, interest, and balance or credit due.

## Audit Assessment Reason(s):

The assessments/adjustments shown are made in accordance with the provisions of Chapter 237, Hawaii Revised Statutes (HRS). The information for this assessment was obtained from your Federal Tax Information and from your Hawaii S Corporation Income Tax Return.

Commissions Unreported Under Section 237-13(9), HRS.

County Surcharge Unreported Under section 237-8.6, HRS.

Form 1120S - Gross Receipts or Sales: $101,886.

A 25% penalty is assessed under section 231-39(b)(1), HRS, for the failure to timely file the required return by the original or extended due date.

A 25% penalty is assessed under section 231-39(b)(2)(A), HRS, for the failure to pay the tax due to negligence or intentional disregard of the rules.

A 10% penalty is assessed under section 237-8.6(g), HRS, for the failure to file the schedule or the failure to correctly report the assignment of the general excise tax by taxation district on the schedule.

## Audit Adjustment(s) Summary:

| Description | As Filed | As Adjusted | Additional Taxable | Rate | Additional Tax |
|---|---|---|---|---|---|
| Commissions | $ 0.00 | $ 101,886.00 | $ 101,886.00 | 0.0400 | $ 4,075.44 |
| Oahu Surcharge | $ 0.00 | $ 101,886.00 | $ 101,886.00 | 0.0050 | $ 509.43 |

## Computation of Total Amount Due on this Period:

| | |
|---|---|
| Total Additional Tax | $ 4,584.87 |
| Failure to Timely File Penalty @ 0% | $ 0.00 |
| County Surcharge Penalty @ 10% | $ 458.49 |
| Other Penalty @ 25% | $ 1,146.22 |
| Non-Interest Bearing Penalty | $ 0.00 |
| Interest @ 8% to 6/20/2019 | $ 577.78 |
| Fees | $ 0.00 |
| **Assessment Amount Due** | **$ 6,767.36** |
| Refund(s), Payment(s) or Credit(s) on this Tax Filing Period | $ 0.00 |
| Pre-Assessment Liability | $ 0.00 |
| Interest on Pre-Assessment Liability | $ 0.00 |
| **Total Amount Due on this Tax Filing Period** | **$ 6,767.36** |

# Exhibit 8

Electronically Filed
FIRST CIRCUIT
1CCV-24-0000661
05-JUL-2024
02:59 PM
Dkt. 43 EXH

**Tax Court & Board of Tax Appeals Memorandum Decisions**

# Thomas J. Masterson, TC Memo 1981-681. , Code Sec(s) 162.

THOMAS J. MASTERSON and ELEANOR P. MASTERSON.

**Case Information:**

[pg. 81-2649]

| | |
|---|---|
| **Code Sec(s):** | 162 |
| **Docket:** | Docket No. 5113-80. |
| **Date Issued:** | 11/25/1981 |
| **Judge:** | Opinion by WILBUR, *J.* |
| **Tax Year(s):** | Year 1975. |
| **Disposition:** | Deficiencies redetermined. |
| **Cites:** | TC Memo 1981-681, PH TCM P 81681, 42 CCH TCM 1758. |

## HEADNOTE

**1. BUSINESS EXPENSES-Proof in support of deductions-absence of satisfactory proof.**
Taxpayer denied business expense deductions (Schedule C) and itemized deductions (Schedule A) in excess of amounts allowed by IRS. But negligence penalty wasn't imposed. Difficulty or expense of reconstructing records didn't excuse taxpayer from burden of proving deductions or permit court to estimate amounts in absence of substantiation of any kind. But delay alone wasn't enough for imposition of negligence penalty where taxpayer was able to substantiate 90% of originally disputed

deductions.

***Reference(s):*** 1981 P-H Fed ¶11,053(5); 16,959(20); 37,265(5). Code Sec. 162; Code Sec. 274; Code Sec. 6653(a).

## Syllabus

## *Official Report*

## Counsel

Thomas J. Masterson, pro se.

Avery Cousins, III, for the respondent.

## MEMORANDUM FINDINGS OF FACT AND OPINION

WILBUR, *Judge:*

Respondent determined a deficiency in petitioners' Federal Income tax for the taxable year 1975 in the amount of $54,365. He also determined substantial additions to tax under sections 6651(a)(1) **1** and 6653(a). However, respondent has now conceded that petitioners' return was timely filed and that the addition to tax under section 6651(a)(1) is inapposite. Additionally, respondent has conceded a $16,000 item of unreported income and petitioners have conceded that a $5,000 loss deducted by them on their 1975 return was not properly deductible until 1976. **2**

The issues remaining for our decision are (1) whether petitioners have substantiated various business expenses claimed by them on the Schedule C's attached to their 1975 return, in excess of the $72,355 now allowed by respondent, (2) whether petitioners have substantiated various itemized deductions claimed by them on the Schedule A attached to the return, in excess of the $4,400 now allowed by respondent, and (3) whether petitioners are subject to the addition to tax imposed by section 6653(a).

## FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly. The stipulation of facts, the first supplemental stipulation of facts, and the exhibits attached to both documents are incorporated herein by reference.

Petitioners Thomas J. and Eleanor P. Masterson, husband and wife, resided in St. Petersburg, Florida, at the time of filing their petitioner herein. They filed a joint Federal income tax return for the 1975 taxable year.

Respondent's statutory notice of January 11, 1980, determined increased adjustments to petitioners' 1975 return in the amount of $106,230. Petitioners originally relied solely on their purported Fifth Amendment rights against self-incrimination, and provided respondent with no records. When informed at trial that the courts have on numerous occasions dismissed similar constitutional defenses as meritless, petitioners agreed to attempt to provide respondent with substantiation of the various claimed deductions.

The evidence presented at trial consisted of a stipulation of facts with exhibits (predominantly cancelled checks) and petitioner Thomas Masterson's testimony. Because of difficulties petitioners had in gathering their documentation, we agreed at that time to leave the record open for a limited time during which the parties could prepare a supplemental stipulation of facts based on additional information to be provided by petitioners.

Based on the documentation supplied to respondent immediately prior to the hearing, at the hearing, and subsequent to the hearing, the original increased adjustments to petitioners' income have been reduced to $13,475. The original adjustments, the amounts allowed by respondent, and respondent't revised disallowances are as follows: [pg. 81-2650]

| | Original Adjustment | Amounts Later Allowed | Amounts Still Disputed |
|---|---|---|---|
| Unreported income | $16,000 | $16,000 | 0 |
| Loss | 5,000 | 0 | $ 5,000<*> |
| Schedule C: | | | |
| Travel | 7,958 | 3,085 | 4,873 |
| Depreciation | 176 | 0 | 176 |
| Taxes | 2,525 | 1,679 | 846 |
| Repairs | 25 | 21 | 4 |
| Paint and materials | 221 | 217 | 4 |
| Commissions | 1,739 | 1,115 | 624 |
| Postage | 718 | 517 | 201 |
| Lot maintenance | 5,615 | 5,513 | 102 |
| Advertising | 5,388 | 4,504 | 884 |
| License fees | 523 | 435 | 88 |
| Franchise fee | 7,200 | 7,200 | 0 |
| Royalties | 9,571 | 9,571 | 0 |
| Rent | 34,058 | 34,058 | 0 |
| Insurance | 1,417 | 1,417 | 0 |
| Telephone | 929 | 929 | 0 |
| Contributions | 70 | 70 | 0 |

| | | | |
|---|---|---|---|
| Cost of goods sold ..... | 1,280 | 1,280 | 0 |
| Supplies ..... | 425 | 579 | (154) |
| Printing and typing .... | 51 | 165 | (114) |
| Schedule A | | | |
| Contributions ..... | 200 | 80 | 120 |
| Interest ..... | 3,702 | 3,451 | 251 |
| Taxes ..... | 1,035 | 815 | 220 |
| Franchise fee ..... | 350 | 0 | 350 |
| Tax preparation ..... | 54 | 54 | 0 |
| Totals | $106,230 | $92,755 | $13,475 |

<*>Valid 1976 loss not in dispute

## OPINION

The issues for our decision include whether petitioners have substantiated their claimed Schedule C business expense and Schedule A itemized deductions. It is a well-established rule that deductions from Federal income tax are a matter of legislative grace. New Colonial Ice Co. v. Helvering, 292 U.S. 435 [13 AFTR 1180] (1934). Thus, petitioners have the burden of proving their entitlement to any amount in excess of that allowed by respondent. Welch v. Helvering, 290 U.S. 111 [12 AFTR 1456] (1933); Rule 142(a), Tax Court Rules of Practice and Procedure.

Respondent argues that petitioners have failed to satisfy this burden. We must agree with respondent.

## Schedule C Business Expenses

Petitioners state as prefatory argument that it was impossible for them to further substantiate their deductions because banks either could not produce copies of their cancelled checks for 1975, or would not produce them free of charge. While we recognize the difficulties involved in reconstruction of one's records for an earlier year, **3** this does not remove the onus of providing supporting evidence for claimed deductions. Burnet v. Houston, 283 U.S. 223 [9 AFTR 1430] (1931).

There is some relief, however, for a taxpayer who does not maintain adequate records or whose records are lost or destroyed. If the taxpayer can present evidence which is both convincing and susceptible of estimation, we can in appropriate circumstances estimate the allowable deductions. Cohan v. Commissioner, 39 F.2d 540 [8 AFTR 10552] (2d Cir. 1930). **4** Petitioners have offered no such evidence; [pg. 81-2651] we have before us only the cancelled checks substantiating amounts no longer

in issue and petitioner Thomas Masterson's bald assertion at trial that they paid all Federal income taxes due.

Petitioners argue that respondent would not accept their paid charge accounts as proof of travel expenses incurred while away from home on business and while traveling from one job location to another.

Section 274 and the regulations thereunder provide rigorous substantiation requirements for the allowance of a deduction for "away from home" travel expenses. To be entitled to the deduction, a taxpayer must show by adequate records the amount, time, place, and business purpose of each expense. It is doubtful that the charge accounts would satisfy these requirements-at the very least, the bills themselves would not show the business purpose of the items charged. In any event, petitioners did not offer these accounts as exhibits or give even uncorroborated testimony on this point. We therefore must find that the requisite substantiation has not been supplied.

Petitioners asserted on brief that one of their businesses **5** required a minimum of 60 miles travel per day between its two locations. The expenses of traveling from one place of business to another are generally deductible, **6** (Tidwell v. Commissioner, 298 F.2d 864 [ 9 AFTR 2d 602] (4th Cir. 1962), affirming a Memorandum Opinion of this Court; section 162) without the stringent substantiation requirements of section 274. However, there is no evidence in the record upon which to verify or estimate petitioners' legitimate travel expenses. A taxpayer's unsworn statement on brief will not suffice.

Petitioners offered no evidence to substantiate either the remaining "away from home" expenses or the cost of travel between two job sites. The deductions for travel expenses in the amount of $4,873 were thus properly disallowed.

Respondent disallowed in its entirety a depreciation deduction of $176 on furniture and fixtures. As petitioners offered no evidence to prove the basis, useful life, salvage value, and portion of use attributable to business **7** for any item, we cannot find that respondent has erred. Gino v. Commissioner, 60 T.C. 304 (1973), revd. on other grounds, 538 F.2d 833 [ 38 AFTR 2d 76-5354] (9th Cir. 1976), cert. denied 429 U.S. 979 (1976); section 167.

Petitioners next argue that an unsubstantiated sales tax deduction **8** in the amount of $846 should be allowed because it was obviously paid or the State would not have allowed them to remain in business. While the figures on the return, **9** and on those cancelled checks substantiating amounts no longer in dispute, all seem to support the validity of petitioners' deduction, we simply have no evidence before us to show that any taxes beyond those conceded by respondent were in fact paid. Petitioners are therefore not entitled to a deduction for the remaining $846 in sales tax.

Various other Schedule C deductions were disallowed by respondent, for which petitioners presented no further evidence and made no arguments. These disallowances were thus proper.

We conclude that petitioners have not sustained their burden of proving that respondent's determination

with respect to their claimed business deductions was incorrect. Hence, they are not entitled to any greater Schedule C deductions than those conceded by respondent.

## Schedule A Itemized Deductions

As noted earlier, petitioners allege their lack of documentation is due in part to their inability to obtain copies of cancelled [pg. 81-2652] checks from their banks. With respect to their itemized deductions, petitioners also allege a credit union failed to produce records of their interest payments for 1975. We are skeptical of petitioners' story, and in any event the deductions claimed must be backed by some evidence of their validity.

To substantiate an interest deduction of $250 still in issue, petitioners introduced the loan agreement evidencing their indebtedness. From this we could determine or estimate the amount of each payment which constituted interest, if petitioners had offered any evidence to prove they actually made the payments due under the agreement. This they failed to do.

Petitioners deducted charitable contributions of $120 made in the form of weekly donations to their church. Petitioners offered no substantiation, oral or otherwise, for these contributions, and on brief, question how they could ever hope to. Section 1.170A-1(a)(2)(iii), Income Tax Regs., states the preferred method of substantiation of charitable contributions.

> SEC. 1.170A-1. Charitable, etc., contributions and gifts; allowance of deduction.

***

> (a)(2)(iii) *Statement from donee organization.* Any deduction for a charitable contribution must be substantiated *** by a statement from the organization to which the contribution was made indicating *** the name and address of the contributor, the amount of the contribution, [and] the date of actual receipt of the contribution *** .

We recognize the problems inherent in substantiating small cash donations, especially those made to churches where the taxpayer usually does not pay by check or obtain a receipt. For this reason we have often allowed or estimated deductions of this kind based on contemporaneous personal records or notations and even uncorroborated, credible testimony by the taxpayer. Lamphere v. Commissioner, 70 T.C. 391 (1978). Regretfully, petitioners offered no evidence on this issue whatsoever, so we cannot find that they are entitled to the charitable deductions claimed.

Respondent also disallowed itemized deductions for the payment of taxes and a franchise fee. As petitioners did not offer evidence or present arguments in support of these claimed deductions, we find that they, too, were properly disallowed.

Petitioners have failed to satisfy their burden of proof with respect to the itemized deductions in dispute. We therefore hold that petitioners are not entitled to any Schedule A deductions in excess of those allowed by respondent.

## Addition to Tax under Section 6653(a)

Respondent asserted an addition to tax under section 6653(a). This section provides that "if any part of any underpayment

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is due to negligence or intentional disregard of rules and regulations

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there shall be added to the tax an amount equal to 5 percent of the underpayment." The parties base their arguments with respect to the addition to tax on the circumstances surrounding the examination of petitioners' return. Specifically, respondent contends that the "inordinate amount of time" the Government spent on petitioners' case, "coupled with petitioners' dilatory tactics **10**

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calls for the imposition of some penalty." We hasten to point out that the section 6653(a) addition to tax is imposed by reason of some negligence or intentional act[s] causing a deficiency, *not* for the amount of time the Government must spend in ascertaining and achieving final resolution of that deficiency. **11** However, respondent's imposition of the addition to tax is presumptively correct, and petitioners bear the burden of proving the assessment wrong. Vaira v. Commissioner, 444 F.2d 770 [ 28 AFTR 2d 71-5033] (3d Cir. 1971), affg. on this issue 52 T.C. 986 (1969); Hatfield v. Commissioner, 68 T.C. 895 (1977).

Although their records were lost or destroyed, petitioners were able to reconstruct most of them through the use of cancelled checks and receipts. Respondent eventually allowed over 90 percent of the disallowed deductions; **12** therefore we can assume petitioners' records, for the most part, must have been adequate. The mere fact that we do not consider their records adequate to substantiate all the deductions claimed for 1975 does not require us to conclude that there was an "underpayment" of tax that was due to petitioners' negligence or intentional disregard of respondent's rules and regulations. Steel v. Commissioner, 437 F.2d 71 [ 27 AFTR 2d [pg. 81-2653] 71-465] (2d Cir. 1971), affg. without discussion of this point a Memorandum Opinion of this Court; Robinson v. Commissioner, 51 T.C. 520 (1968), affd. per curiam 422 F.2d 873 [ 25 AFTR 2d 70-807] (9th Cir. 1970). We therefore hold that petitioners are not liable for the addition to tax provided in section 6653(a).

To reflect the foregoing,

*Decision will be entered under Rule 155.*

**1** Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended.

**2** The parties agree that the partnership interest from which the loss derived did not become worthless until 1976.

**3** Petitioner Thomas Masterson testified without further explanation that all his records were destroyed or lost.

**4** Sec. 274(d) supersedes Cohan v. Commissioner, 39 F.2d 540 [8 AFTR 10552] (2d Cir. 1930) where the deductions are for certain enumerated expenses. Sec. 1.274-5(a), Income Tax Regs.

**5** Petitioners operated two businesses during 1975: Silva Mind Control, a training and lecture service, and Parking Company of America, a car parking business with lots in St. Petersburg and Tampa, Florida.

**6** Commuting expenses between work and home, however, are not deductible. Sec. 1.162-2(a), Income Tax Regs.

**7** The depreciation was claimed on the Schedule C Statement of Profit and Loss for Silva Mind Control. As the business address of Silva Mind Control was the same as the home address of petitioners, part of the depreciation may well have related to personal use, for which no deduction is allowed.

**8** Petitioners assert that the calculation for their original deduction is simple: 4 percent of the gross receipts listed on the Parking Co.'s Schedule C. Fla. Stat. Ann. sec. 212.01 et seq. imposes a tax on the lessor of private parking facilities at the rate of 4 percent on the total rentals received. Under Arrigoni v. Commissioner, 73 T.C. 792, 803 (1980), the payment of this tax by petitioners would be a valid deduction if substantiated; respondent in fact allowed petitioners a deduction to the extent of the cancelled checks produced.

**9** Petitioners' 1975 tax return was an exhibit attached to the parties' stipulation, but the return is merely a statement of the petitioners' claim and does not establish the facts contained therein.

Roberts v. Commissioner, 62 T.C. 834 (1974); Seaboard Commercial Corp. v. Commissioner, 28 T.C. 1034 (1957).

**10** Petitioners' "dilatory tactics" were based on what we believe to be sincere, albeit misguided, beliefs as to their constitutional and procedural rights.

**11** For this the Government has the general summons power conferred by secs. 7602 et seq. and its derivative court sanctions. Also, sec. 6673 allows us to assess damages of up to $500 when it appears that the taxpayer instituted proceedings merely for delay.

**12** The $5,000 loss conceded to be a valid loss deduction for the subsequent year, was excluded from this computation.

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