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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 MOTION FOR SUMMARY JUDGMENT; MEMORANDUM IN SUPPORT OF MOTION; DECLARATION OF THOMAS YAMACHIKA; EXHIBITS 1-8; NOTICE OF HEARING and CERTIFICATE OF SERVICE HEARING DATE AND TIME: Nov. 19 2024, 2:00 p.m. HONORABLE KARIN L. HOLMA TRIAL: Week of Feb. 3, 2025

MOTION FOR SUMMARY JUDGMENT

Comes now TAX FOUNDATION OF HAWAIʻI, Plaintiff, and moves this Honorable Court, pursuant to Rules 7 and 56, Hawaii Rules of Civil Procedure, for summary judgment in this matter.

This motion is based on the attached Memorandum, declarations, and exhibits attached hereto, and the records and file of this case.

DATED: Honolulu, Hawaii, October 28, 2024.

/s/ Thomas Yamachika

THOMAS YAMACHIKA
Attorney for Plaintiff

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 MEMORANDUM IN SUPPORT OF MOTION

MEMORANDUM IN SUPPORT OF MOTION

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MEMORANDUM IN SUPPORT OF MOTION

I. STATEMENT OF FACTS

Plaintiff Tax Foundation of Hawai'i (the **Foundation**) is moving for summary judgment. This action challenges certain orders the Director of Taxation made to his staff through a non-public document called Administrative Directive 2021-01 (hereinafter AD 2021-01), a copy of which is attached as Exhibit 1 to this motion. This case is about whether its contents comport with applicable law, specifically the Hawaii Administrative Procedure Act ("HAPA"), HRS Chapter 91, and the statute on which it purports to provide guidance.

On May 18, 2023, the Foundation requested under the Uniform Information Practices Act, HRS Chapter 92F, that the Department of Taxation (**Department**) produce its "Administrative Directives." (Exhibit 2.) The Department duly produced eleven documents in response to this request out of "about 145" Administrative Directives in total.[1] AD 2021-01 was one of them.[2] A correct copy of AD 2021-01 appears in this Court's file as the only exhibit (Dkt. #65, reproduced as Exhibit 1)) to a Stipulation of Facts filed herein on Oct. 23, 2024 (Dkt. #64, reproduced as Exhibit 3).

[1] Deposition of Gary Yamashiroya, 26:13-23 (Exhibit 5).
[2] See also Department's Answer to Complaint (Dkt. #17), ¶ 9: "In answer to paragraph 8 of the Complaint, the Department states that on May 4, 2024, the Department emailed a copy of Administrative Directive No. 2021-01 to Tom Yamachika, Tax Foundation of Hawaii, in response to a Uniform Information Practices Act, chapter 92F, HRS, request."

In general, Administrative Directives are "policy pronouncements," as the Department's Special Assistant to the Director of Taxation, Gary Yamashiroya,[3] testified explicitly:

> Q … 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.
>
> ….
>
> 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.

Deposition of Gary Yamashiroya, 19:1-7, 20:1-22 (Exhibit 5).

[3] Yamashiroya Deposition, 12:8-9. (Exhibit 4).

AD 2021-01, dated April 27, 2021 (Exhibit 1), states that its purpose "is to assess all applicable penalties under Title 14, Hawaii Revised Statutes (HRS)."[4] The document originates with the Office of the Director of Taxation, and is signed by the Director, at the time Isaac Choy, on page 2. It is marked "For Internal Use Only." The parties have stipulated that the document (1) was placed on the Department of Taxation's internal shared drive and accessible to employees of the Department of Taxation; (2) was not uploaded onto the Department's internet website or otherwise made readily accessible to the public; and (3) has not been superseded or obsoleted, and currently remains in effect. (Dkt. #64, reproduced as Exhibit 3).

Among other pronouncements in AD 2021-01 are "additional guidance" on the penalty for failure to pay tax due to negligence (the "Negligence Penalty"), as stated in HRS § 231-39(b)(2)(A). That statute, quoted in the AD, states:

> 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.

The directive then states that "[n]egligence or disregard of rules or regulations include, but are not limited to, the following circumstances:" and lists five bullet points, the last of which is:

- 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 [*sic*] 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.

[4] Title 14, HRS, is where the tax chapters are located as well as certain chapters common to multiple tax types, such as HRS chapter 231, relating to administration of taxes.

This bullet point will be referred to hereinafter as the **Failure to Respond Condition**. The remaining bullet points will be referred to hereinafter as the **Four Other Circumstances**.

II. ARGUMENT

A. Applicable Legal Standard for Motion.

Summary 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 a judgment as a matter of law. *CompUSA Stores, L.P. v. State,* 142 Haw. 304, 309, 418 P.3d 645, 650 (2018); *Travelocity.com, L.P. v. Director of Taxation*, 135 Haw. 88, 96-97, 346 P.3d 157, 165-66 (2015).

No particular deference needs to be given to the Department's interpretation of a statute, because "if a statute does not grant an agency discretion with which to interpret or implement that statute, then that agency's legal conclusions will be reviewed *de novo*." *Paul's Electrical Service, Inc. v. Befitel,* 104 Haw. 412, 417, 91 P.3d 494, 499 (2004). This principle applies both to the tax statutes and to non-tax statutes such as HAPA and HRS chapter 632.

B. The Failure to Respond Condition Goes Dangerously Beyond the Statute It Purports to Interpret by Allowing the Penalty to Be Imposed for Unrelated Conduct.

The Failure to Respond Condition is pernicious. It goes far beyond the statute about which it is designed to provide "guidance," and has the potential to adversely and illegally affect taxpayers under audit.

The Negligence Penalty provides for a penalty to be assessed against a taxpayer "[i]f any part of any underpayment is due to negligence or intentional disregard of rules." HRS § 231-39(b)(2)(A). That means that there must be (1) negligence or intentional disregard of rules ***causing*** (2) an underpayment of tax on a tax return. The amount of the penalty is 25% of the amount of the underpayment. The underpayment can occur no later than the due date for the tax return in question, for that is when the tax legally due can be compared with the tax shown on the return (or zero, if no return is filed). The Failure to Respond Condition, however, necessarily must be triggered later still, when the taxpayer is under audit, the examiner or auditor asks for records, and the taxpayer does not provide them on time. The Failure to Respond Condition, then, cannot ***cause*** an underpayment. It has nothing to do with the Negligence Penalty and cannot legally trigger the Negligence Penalty.

Put another way, an underpayment of tax that the Negligence Penalty penalizes either already exists, or does not exist, **before** any audit of a taxpayer's return. If any underpayment exists, it is either "due to negligence or intentional disregard of rules" or it is not, but either way, the facts exist **before** any audit is started. Thus, a statutory basis for the negligence penalty either exists, or does not exist, before any audit begins. Nothing that happens **during** the audit can be relevant to whether there is a statutory basis for the negligence penalty. And, if there is no statutory basis for the negligence penalty, the penalty cannot be lawfully imposed.

In *Masterson v. Commissioner,* T.C. Memo. 1981-681 (a copy of which is included as Exhibit 8), the U.S. Tax Court rejected an argument from the Internal Revenue Service that a taxpayer's "dilatory tactics," along with an "inordinate amount of time" the Government was required to spend on the taxpayer's case, justified application of the Negligence Penalty under IRC § 6653 (now IRC § 6662(b)(1)). There, the court stated, "We hasten to point out that the [Negligence Penalty] 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." (Footnote omitted, emphasis in original.) The court voided the Service's assessment of the negligence penalty.

As the Negligence Penalty statute clearly shows and the *Masterson* court confirms, the Failure to Respond Condition cannot lawfully be used as a basis to impose the Negligence Penalty. Thus, the Failure to Respond Condition is invalid.

In practice, specific cases of this condition being used to injure taxpayers may be difficult or impossible to identify. The negligence penalty typically appears as one cryptic line in a much larger assessment: "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." (Exhibit 7.) And then, despite the lack of specifics, it then becomes the *taxpayer's* burden to *disprove* the penalty. *In re Travelocity.com, L.P.,* 135 Haw. 88, 115, 346 P.3d 157, 184 (2015). That is why it is important for this Court to provide a check and

balance against unreasonable uses of the executive power before it is wielded against an unsuspecting public.

C. The Failure to Respond Condition and the Four Other Circumstances Are "Rules" as Used in HRS § 91-1, and Are Invalid for Failure to Comply with Rulemaking Procedures.

Under HRS § 91-1, a "rule" means

> 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.

In *Ainoa v. Unemployment Compensation Appeals Division,* 62 Haw. 286, 614 P.2d 380 (1980), the Department of Labor and Industrial Relations (DLIR) had given its unemployment claims referees "cheat sheets" containing definitions of "descriptive words and phrases," as DLIR called them, which DLIR referees then used to adjudicate unemployment claims. The Hawaii Supreme Court held that these sheets were "rules" within the meaning of HAPA, *id.* at 292-93, 614 P.2d at 385, and then, after noting that DLIR was supposed to but did not make those sheets public information, hold a public hearing, obtain approval of the Governor or file them with the Lieutenant Governor, declared the rules invalid, *id.* at 293-94, 614 P.2d at 385-86.

Here, the guidelines the Department gave to its staff relating to the Negligence Penalty in AD 2021-01, namely the Failure to Respond Condition and the Four Other Circumstances, are just like the internal "cheat sheets" in *Ainoa*. The guidance, in interpreting the Negligence Penalty, is a statement of

policy. The Department's witness described ADs as "policy pronouncements." Yamashiroya Depo., at 19:6-7 (Exhibit 5). The guidance is not wholly internal to the agency because it affects the rights of the taxpaying public. *Waugh v. University of Hawaii*, 63 Haw. 117, 131, 621 P.2d 957, 968 (1980); *Holdman v. Olim*, 59 Haw. 346, 355, 581 P.2d 1164, 1170 (1978). Thus, the directives in AD 2021-01 are rules within the meaning of HAPA.

There is no dispute that AD 2021-01, just like the "cheat sheets" in *Ainoa,* was not public information. The document states that it is for internal use only, and it has been stipulated that it was not made publicly accessible. Stipulation of Facts, Dkt. #64 (Exhibit 3). Whether or not any of the other steps in the process were followed, the statutory rulemaking process has not been complied with.

The rule-making provisions of HAPA include requirements for public notice and comment. Those provisions are designed to give the public and affected parties a fair opportunity to participate in the process. Where the rule-making process is not complied with, "[t]he public has been afforded no meaningful opportunity to shape these criteria that affect their interest." *In re Hawai'i Prince Hotel Waikiki Corp.*, 89 Haw. 381, 393, 974 P.2d 21 (1999) (quoting *Aluli v. Lewin*, 73 Haw. 56, 60, 828 P.2d 802, 804 (1992)). "Where an administrative agency seeks to promulgate a 'rule,' it must consider the views of interested persons . . . for the powers . . . of government should not be used in a manner giving the appearance of being arbitrary." *Vega v. National Union Fire Insurance Co.*, 67 Haw. 148, 156, 682 P.2d 73, 78 (1984).

Where an agency issues a "rule" (as defined in HAPA) without following the rule-making requirements, that rule is not valid. HRS § 91-7(b) provides that the court **shall** declare a rule invalid if the court finds that the rule violates constitutional or statutory provisions, exceeds the statutory authority of the agency, or was adopted without compliance with the rule-making procedures set forth in Chapter 91. The Failure to Respond Condition and the Four Other Circumstances are in the same boat here and must sink together.

D. The Tax Foundation of Hawaii Is an "Interested Person" Under HAPA.

In a suit for a declaratory judgment such as this one, the plaintiff must either meet the requirements of the Declaratory Judgment Act, HRS § 632-1, or be an "interested person" within the meaning of the Hawaii Administrative Procedure Act. HRS § 91-7(a). It is not necessary that the plaintiff must be "aggrieved," as is necessary when challenging the decision of a contested case. HRS § 91-14(a). In *Asato v. Procurement Policy Board*, 132 Haw. 333, 322 P.3d 228 (2014), the court explained that in this jurisdiction the courts have broadened standing in actions challenging administrative decisions and in cases of public interest. *Id.* at 344, 322 P.3d at 239. "Our basic position has been that standing requirements should not be barriers to justice." *Life of the Land v. Land Use Comm'n of State of Hawaii*, 63 Haw. 166, 174, 623 P.2d 431, 439 (1981) (noting that "[U.S.] Supreme Court doctrine on this issue does not bind us" and that standing under Hawaii law is broader than standing under federal rules).

The courts impose a tighter "injury in fact" requirement where the litigant seeks to do no more than vindicate his or her own value preferences through the judicial process. But in a declaratory judgment action as to the validity of a rule serves to uphold the legislature's intent in the area, not the plaintiff's. *Asato*, 132 Haw. at 345, 322 P.3d at 240. In *Tax Foundation of Hawai'i v. State,* 144 Haw. 175, 439 P.3d 127 (2019), the court held that this Plaintiff had standing to seek a declaratory judgment "based on its historical purpose as a governmental financial accountability watchdog." Plaintiff again seeks to do so here.

III. CONCLUSION

For the reasons here stated, the taxpaying public is entitled to a judgment from this Court declaring the invalidity of the extremely misguided Failure to Respond Condition and similarly limiting the legal effect of "secret law" that may then be used to illegally penalize unsuspecting taxpayers.

DATED: Honolulu, Hawaii, October 28, 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. On October 9, 2024, I took the deposition of Mr. Gary Yamashiroya, who identified himself as Special Assistant to the Director of Taxation, on behalf of Plaintiff.

3. The following exhibits are true and correct copies of the indicated pages of the transcript of the deposition of Mr. Gary Yamashiroya:

Exhibit	Page(s) of Yamashiroya Depo.
4	12
5	19-20
6	26

4. The following exhibits are reproductions of documents filed in this case:

Exhibit	Docket No.
3	64
1	65

5. Attached as Exhibit 2 is a copy of a Uniform Information Practices Act request that I submitted to the Department of Taxation on behalf of the Plaintiff.

6. Exhibit 7 is an excerpt from an assessment notice filed as an exhibit to an existing Hawaii Tax Appeal Court case, No. 1CTX-20-0000106. In my experience, the wording of the negligence penalty assessment in this notice is typical of notices of assessments of the negligence penalty.

7. Attached as Exhibit 8 is a copy of a Memorandum Opinion of the United States Tax Court, Thomas J. Masterson, T.C. Memo. 1981-681.

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

DATED: Honolulu, Hawaii, October 28, 2024.

/s/ Thomas Yamachika
THOMAS YAMACHIKA

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 NOTICE OF HEARING and CERTIFICATE OF SERVICE HEARING DATE AND TIME: Nov. 19 2024, 2:00 p.m. HONORABLE KARIN L. HOLMA TRIAL: Week of Feb. 3, 2025

NOTICE OF HEARING

TO: 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

NOTICE IS HEREBY GIVEN that Appellant's Motion for Summary Judgment shall come on for hearing before the Honorable Karin L. Holma, Judge of the above-entitled Court, in her courtroom in the Kaahumanu Hale Building, 777 Punchbowl Street, Honolulu, Hawaii, on Nov. 19, 2024, at 2:00 p.m., or as soon thereafter as counsel can be heard.

DATED: Honolulu, Hawaii, October 28, 2024.

/s/ Thomas Yamachika
THOMAS YAMACHIKA
Attorney for Appellant

CERTIFICATE OF SERVICE

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

DATED: Honolulu, Hawaii, October 28, 2024.

/s/ Thomas Yamachika
THOMAS YAMACHIKA
Attorney for Appellant