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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

MEMORANDUM IN OPPOSITION TO DEFENDANT DEPARTMENT OF TAXATION, STATE OF HAWAII'S MOTION TO DISMISS COMPLAINT FOR DECLARATORY JUDGMENT, OR, IN THE ALTERNATIVE, CROSS-MOTION FOR SUMMARY JUDGMENT; DECLARATION OF THOMAS YAMACHIKA; EXHIBITS 1-7 and CERTIFICATE OF SERVICE

HEARING DATE AND TIME:
December 19, 2024, 2:00 p.m.

HONORABLE KARIN L. HOLMA

TRIAL: Feb. 3, 2025

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MEMORANDUM IN OPPOSITION TO DEFENDANT DEPARTMENT OF TAXATION, STATE OF HAWAII'S MOTION TO DISMISS COMPLAINT FOR DECLARATORY JUDGMENT, OR, IN THE ALTERNATIVE, CROSS-MOTION FOR SUMMARY JUDGMENT

I. DISCUSSION

Plaintiff Tax Foundation of Hawai'i (the "Foundation") opposes the Department's motion. From the tenor of the Department's motion, it is clear that the Department claims the right to impose penalties where it wants, when it wants, the provisions of the penalty statutes notwithstanding; and it wishes to instruct its staff while being answerable to no one, especially not to a governmental financial accountability watchdog like the Foundation. This, of course, is not the government we have.

A. Nonprofit Associations Have Been Held to Be Proper Plaintiffs in Declaratory Judgment and Chapter 91 Actions, and the Foundation Is a Proper Plaintiff Here.

1. Nonprofits Have Been Plaintiffs In Important Cases in Hawaii.

In Hawaii, many nonprofit organizations contribute to the public good each day. Some contribute by adding to the jurisprudence of our State. Thus, in *Life of the Land v. Land Use Commission*, 63 Haw. 166, 176-77, 623 P.2d 431, 441 (1981), the nonprofit Life of the Land was held to be an interested person for HRS Chapter 91 purposes even though neither it nor its members were owners or adjoining owners of land reclassified in a boundary review. In *Hawaii Insurers Council v. Lingle,* 120 Haw. 51, 72, 201 P.3d 564, 585 (2008), the Hawaii Insurers Council, a nonprofit trade organization and not an insurer,

brought a declaratory action[1] to obtain important clarification from our supreme court on what constitutes a "user fee" versus a "tax." And in *Tax Foundation of Hawaii v. State,* 144 Haw. 175, 202-03, 439 P.3d 127, 154-55 (2019), our supreme court held that Plaintiff had standing to bring a declaratory judgment action to challenge the State's "skimming" of county surcharge funds even though it could not allege that it had suffered an "injury in fact" because of the diversion.

The Foundation, like other nonprofits, is permitted to vindicate the rights of its constituents in declaratory and Chapter 91 actions. It may do so here.

2. The Foundation's Action Does Not Restrain the Department's Lawful Power to Assess and Collect Taxes.

The Department argues that this suit must be dismissed because the Foundation is interfering with its duties to assess and collect taxes. The Foundation has no interest in restraining or impeding the lawful functions of Defendant Department of Taxation ("Department"). But the Foundation and its constituents do have an interest in making sure that the Department's functions ***are*** lawful, and that the Department is administering Hawaii's tax laws without feeding its staff toxic disinformation.

The Department insists that this case is a controversy with respect to taxes and thus runs afoul of the proviso in the first sentence of HRS § 632-1(a),

[1] The Insurers Council sought declaratory relief among other remedies. 120 Haw. at 56, 201 P.3d at 569.

but it reaches that conclusion by missing the second sentence in HRS § 632-1(a) that explicitly allows for the challenge presented here:

> **§632-1 Jurisdiction; controversies subject to.** [(a)] In cases of actual controversy, courts of record, within the scope of their respective jurisdictions, shall have power to make binding adjudications of right, whether or not consequential relief is, or at the time could be, claimed, and no action or proceeding shall be open to objection on the ground that a judgment or order merely declaratory of right is prayed for; provided that declaratory relief may not be obtained in any district court, or in any controversy with respect to taxes, or in any case where a divorce or annulment of marriage is sought. **Controversies involving the interpretation of deeds, wills, other instruments of writing, statutes, municipal ordinances, and other governmental regulations may be so determined,** and this enumeration does not exclude other instances of actual antagonistic assertion and denial of right.

HRS § 632-1(a) (emphasis added). This case involves the interpretation and validity of AD 2021-01 which is a written instrument and/or an "other governmental regulation[]." This action may proceed because it is within the exception to the proviso the Department is citing.

In addition, our supreme court held that declaratory relief may be obtained even in tax matters "where such relief does not interfere with the assessment or collection of taxes." *Tax Foundation,* 144 Haw. at 188, 439 P.3d at 140. The Department, however, has no power to assess or collect tax ***illegally.*** It has only the powers given to it by statute. HRS § 231-3(1), which gives the Department its assessment power, gives the Department the power to "make any assessment **by law** required to be made." HRS § 231-3(2), which covers the collection power, tells the Department to "be responsible for the collection of all taxes imposed **under title 14,** except those which **by law** are to be collected by county treasurers, and for such other duties as are provided **by law**". Specifically with respect to penalties, HRS § 231-3(4) requires the

Department to "see that penalties are enforced **when prescribed by any tax or revenue law of the State**." (Bold type has been added.) Simply put, the Department has no ability to avoid the law and thereby run roughshod over the taxpaying public. Like any other government agency, the Department has no right to complain when this Court confines the Department to its legally authorized sphere of authority.

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 13, is just wrong. 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.[2] It is what the taxpayer put on the return, or the taxpayer's failure to file a return by the due date, 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

[2] HAR § 18-231-3-14.25, which states that noncompliance with recordkeeping rules can be used as evidence of negligence or intent to evade the payment of taxes, is not inconsistent. A taxpayer putting numbers down on a return without adequate support, for example, is negligent *with respect to the position taken on the taxpayer's return.* A taxpayer's inability to promptly produce that support during an audit years later may or may not indicate the absence of support when the return was prepared and filed.

motorist ***made the left turn recklessly?*** Obviously not. That is what *Masterson v. Commissioner,* T.C. Memo. 1981-681, stands for, and the negligence penalty statute should be interpreted accordingly.

3. The Foundation Does Not Have an Alternative Remedy in Tax Appeal Court; Thus, Relief Is Not Barred by HRS § 632-1(b).

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). The Department's argument that the Foundation has a statutory alternative remedy is incorrect.

4. There Is No Conflict Between HRS § 632-1 and HRS § 91-7.

The Department argues that although HRS § 91-7 permits this Court to make "a judicial declaration as to the validity of any agency rule," this permission is taken away because it conflicts with HRS § 632-1's prohibition on declaratory judgments related to tax controversies. However, as discussed in section 2 above, there is actually no conflict between the two statutes because HRS § 632-1 expressly permits judicial declarations relating to written instruments in general and agency rules in particular.

5. The Department Is Not Exempt from Chapter 91, HRS, Relating to the Requirements of Rulemaking.

"As stated in the 1961 Hawaii House Journal-Standing Committee Reports, Standing Committee Report No. 8, HAPA was adopted to 'provide a uniform administrative procedure for all state and county boards, commissions, departments or offices which would encompass the procedure of rule making and the adjudication of contested cases.'" *Town v. Land Use Commission,* 55 Haw. 538, 545, 524 P.2d 84, 89 (1974). Unless there is a statute providing an exemption to the Department, "as a state agency, [it] must conform to the requirements of HAPA when acting in either a rule making capacity (quasi-legislative), or in the adjudication of a contested case (quasi-judicial)." *Id.*

The Department argues that discretionary authority given to the Department in HRS § 231-3(9) and the legislative mandate to promulgate rules explaining the penalties and fines for, among other things, the understatement of taxes in HRS § 231-10.6 (note that the Negligence Penalty under HRS § 231-39(b)(2)(A) does indeed fall into this category because it is a *penalty for understating taxes* without good reason), somehow gives the Department a get-out-of-chapter-91-free card. Those statutes do no such thing. The website of the Office of the Lieutenant Governor, the agency responsible for filing completed rules, is filled with rules explaining how agencies large and small are going to exercise the discretion given to them by the legislature. These rules are subject to Chapter 91 procedures. Moreover, HRS § 231-10.7, which allows the Department to issue temporary rules, contains an explicit exception

to chapter 91, but temporary rules must be made public and be approved by the governor, among other things, so that statute cannot save AD 2021-01. Instead, that statute, by creating an exception to chapter 91, strongly implies that chapter 91 applies to the Department outside of the temporary rules context.

6. The Foundation Otherwise 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 can be an interested person "in cases in which the rights of the public might otherwise be denied hearing in a judicial forum." 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).

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 alleged factual deficiencies that it contends precludes declaratory relief. It maintains that Exhibits 2, 4, 5, 6, and 7 are inadmissible and that the Foundation has no case without them.

1. Exhibits 4, 5, and 6 (Deposition Transcript Excerpts) Are Proper and Are Not Inadmissible Hearsay Because of the Party Admission Exception.

Deposition transcripts are explicitly allowed in summary judgment practice. HRCP 56(c).[3] The deposition in question was taken under HRCP 30(b)(6), in which the Department was asked to and did designate a representative as a witness. (Dkt. #61.) Mr. Yamashiroya stated in his deposition that he was so designated:

> (Whereupon, Exhibit 1 was marked for identification.)
>
> MR. YAMACHIKA: Okay.
>
> Q All right. So, Mr. Witness, are you familiar with this document?
>
> A Yes.
>
> Q Can you tell me what it is.
>
> A I believe it's the rescheduling of this deposition.
>
> Q And this is the Notice of Deposition pursuant to which you're here today. Is that correct?
>
> A Yes.

Yamashiroya Depo. at 8:19-9:5 (Exhibit 1).

[3] "The judgment sought shall be rendered forthwith 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." (Emphasis added.)

Authentication of deposition transcript excerpts by the attorney who took the deposition is an acceptable means of authentication. *Greenspan v. LADT, LLC,* 191 Cal. App. 4th 486, 523, 121 Cal. Rptr. 3d 118, 147 (2010).

This deposition was certified by the Certified Shorthand Reporter who prepared the transcript. Also, after completion of the deposition, Mr. Yamashiroya signed a certificate attesting that the deposition was a true and correct transcript of his testimony with corrections not here relevant. (Exhibit 6.)

The testimony given is not hearsay because it is the party's own statement through a representative. HRE 803(a)(1)(A); *Kekua v. Kaiser Foundation Hospital,* 601 P.2d 364, 371, 61 Haw. 208, 217 (1979) ("The extrajudicial statements of a party-opponent, when offered against the same, are universally deemed admissible at trial as substantive evidence of the fact or facts stated.")

2. Exhibit 2 Was Authenticated By the Department's Witness.

Exhibit 2 in support of the Foundation's Motion for Summary Judgment was identified as Exhibit 4 to Mr. Yamashiroya's deposition:

> Q So we can come back to that. Let's turn your attention now to Exhibit 4. Let me know when you've had a chance to review it.
>
> MS. UDUI: Again, I'm going to reiterate our objection; lack of foundation.
>
> MR. YAMACHIKA: The reason why we're having this deposition is to get the foundation.
>
> MS. UDUI: I note my objection for the record, lack of foundation.
>
> BY MR. YAMACHIKA

Q Mr. Witness, do you recognize this document?

A Yes.

Q Can you tell me what it is.

A It appears to be the UIPA request -- an UIPA request that was submitted by the Tax Foundation.

Q Okay. And do you recall what the Department's response to this was?

MS. UDUI: Again, lack of foundation.

BY MR. YAMACHIKA

Q This, meaning the particular request that is represented by Exhibit 4.

A I do, yes.

Q And what do you remember?

A I remember that we did provide Administrative Directives in response to this request.

Yamashiroya Depo. at 32:13-33:12 (Exhibit 3); Depo. Exhibit 4 (Exhibit 5).

3. Exhibit 7, Part of This Court's Records, Can Be Judicially Noticed.

Exhibit 7 is part of a document filed in Hawaii Tax Appeal Court with the file mark of that court. Records of the court are proper subjects for judicial notice. HRE 201; *State v. Akana,* 68 Haw. 164, 165, 706 P.2d 1300, 1302 (1985). A certified copy of this document is filed herein as Exhibit 7, and such certified copy is self-authenticating. HRE 902(1), (4); *State v. Davis,* 133 Haw. 103, 120-21, 324 P.3d 912, 930-31 (2014).

In addition, the Foundation submits that the inclusion or exclusion of this document is not material to this case because a judgment of validity or invalidity of AD 2021-01 can be rendered without it.

4. The Validity of AD 2021-01 Can Be Adjudicated Without a Showing of the Document's Actual Distribution and the Department's Compliance – But There Is Evidence Showing Both.

In its opposition, the Department seems to be saying that the Foundation has not proved the extent of internal distribution of AD 2021-01 or that anyone followed it, and that this case is over as a result.

The question of whether the document is consistent with statute, however, is an issue of law and can be adjudicated whether or not the document has been distributed or has been followed by Department employees. The question of whether it is a "rule" within the meaning of HRS § 91-1 turns on whether it is an "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." Whether the document was published or followed is not material to this litigation.

In any case, however, the Department's own witness described the effects of the document at issue:

> Q … So let's talk about Administrative Directives, which is kind of why we're here today.
>
> 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.

Yamashiroya Depo., 18:23-20:22 (Exhibit 2). And further:

Q Okay. So you have "Knowledge of whether the guidance on the first page of Administrative Directive 2101-01... was distributed to, used by, or otherwise implemented in taxpayer examinations or audits." You see that?

A Yes.

Q Okay. Was the guidance on the first page of Administrative Directive 2021-01 distributed to audit staff?

A Yes.

Q Do you have knowledge as to whether this guidance was used by audit staff?

A I think that question is a little too broad, because it depends on each audit. But, generally speaking, we do -- when we issue Administrative Directives, we -- our expectation is that our staff will -- will adhere to it, or follow it.

….

Q Do you have "Knowledge of whether any Department staff to which AD 2021-01 was distributed either disagreed with the guidance provided or failed to implement that guidance"?

MS. UDUI: Compound question.

THE WITNESS: Do I have knowledge of it? Yes.

BY MR. YAMACHIKA

Q And what is that knowledge?

A The answer is no.

Q So, to your knowledge, nobody's disagreed with the guidance provided?

A Correct.

Q And, to your knowledge, nobody’s failed to implement that guidance?

A Correct.

Yamashiroya Depo., 49:13-51:9 (Exhibit 4).

From these excerpts, all of which are admissible party admissions as discussed in subsection 1 above, there is plenty of evidence from which the Court may conclude that AD 2021-01 was distributed to and followed by Department staff.

5. The Validity of AD 2021-01 Can Be Adjudicated Without a Victim.

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.

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 this document has not been exposed to public notice and comment. HAPA says that such documents are invalid, and the Foundation seeks a judgment so holding.

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 the Department's Motion to Dismiss or for Summary Judgment be denied.

DATED: Honolulu, Hawaii, December 11, 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.
1	8-9
2	18-20
3	32-33
4	49-51
5	Exhibit 4

4. Exhibit 6 is a true and correct copy of a Reporter's Certificate, Correction Sheet, and Witness' Certificate that I received from the offices of the court reporter who transcribed the deposition of Gary Yamashiroya referred to above.

5. Exhibit 7 is a certified copy of an assessment notice filed as an exhibit to an existing Hawaii Tax Appeal Court case, No. 1CTX-20-0000106.

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

DATED: Honolulu, Hawaii, December 11, 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 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, December 11, 2024.

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