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Electronically Filed
FIRST CIRCUIT
1CCV-24-0000661
16-DEC-2024
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IN THE CIRCUIT COURT OF THE FIRST CIRCUIT

STATE OF HAWAII

In re DEPARTMENT OF TAXATION, ADMINSTRATIVE DIRECTIVE NO. 2021-01. TAX FOUNDATION OF HAWAI'I, a Hawai'i nonprofit corporation, Plaintiff, vs. DEPARTMENT OF TAXATION, STATE OF HAWAI'I, Defendant.	CIVIL NO. 1CCV-24-0000661 DEFENDANT DEPARTMENT OF TAXATION, STATE OF HAWAII'S **REPLY** TO PLAINTIFF'S MEMORANDUM IN OPPOSITION TO MOTION TO DISMISS COMPLAINT FOR DECLARATORY JUDGMENT, OR, IN THE ALTERNATIVE, CROSS-MOTION FOR SUMMARY JUDGMENT; CERTIFICATE OF SERVICE HEARING: Date: December 19, 2024 Time: 2:00 p.m. Judge: The Honorable Karin L. Holma Trial Date: February 3, 2025

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

Defendant DEPARTMENT OF TAXATION, STATE OF HAWAII ("Department"), by and through its undersigned attorneys, respectfully submits this reply to PLAINTIFF'S 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 filed on December 11, 2024 ("Plaintiff's Opposition") [*Dkt. 95*].

I. INTRODUCTION

This case can be dismissed for lack of subject matter jurisdiction. Granting of the Department's Motion to Dismiss Complaint for Declaratory Judgment, or in the Alternative, Cross-Motion for Summary Judgment ("Department's Motion") is mandated by the express statutory prohibition against declaratory judgments in controversies related to taxes set forth in Hawaii Revised Statutes ("HRS") § 632-1(a). Plaintiff fails to overcome this initial burden to demonstrate that this Court has the jurisdiction to adjudicate this action. Section 632-1(b), HRS, similarly requires dismissal of this action because declaratory relief is not available where a specific statutory form of remedy for specific types of cases – in this case a challenge to an assessment of additional taxes – must be heard by the Tax Appeal Court. Finally, Plaintiff fails to demonstrate that it has standing to bring this Complaint as an "interested" party pursuant to HRS § 91-7. Plaintiff's Opposition fails to adequately refute the arguments set forth in the Department's Motion alleging a lack of subject matter jurisdiction, and as such, must be dismissed.

II. **ARGUMENT**

A. THIS COURT LACKS SUBJECT MATTER JURISIDICTION TO ADJUDICATE THIS MATTER AS IT RELATES TO A CONTROVERSY RELATED TO TAXES.

1. This Case Involves a Controversy Related to Taxes.

Plaintiff's Opposition fails to adequately overcome the express prohibition against declaratory judgments in controversies related to taxes pursuant to HRS § 632-1(a). Section 632-1(a), Hawaii Revised Statutes ("HRS") provides:

> 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.

Plaintiff argues that despite the express language of HRS § 632-1 specifically prohibiting declaratory relief in controversies related to taxes, declaratory relief is permissible because this matter involves a written instrument or governmental regulation. See Plaintiff's Opposition at 3. This argument fails as nothing in HRS § 632-1(a) permits an alternate basis for declaratory relief where, as here, the case is a controversy related to taxes.[1] A case is a "controversy with respect to taxes," when granting declaratory relief would interfere with the government's ability to assess or collect taxes. *Tax Foundation of Hawaii v.* State, 144 Haw. 175, 188, 439 P.3d 127, 140 (2019) ("*Tax Foundation 2019")*.

[1] To follow Plaintiff's logic, a person would be able to obtain declaratory relief regarding a municipal ordinance in district court.

As noted in the Department's Motion, the penalties imposed by HRS § 231-39(b)(2)(A) are added to and become part of the tax liability. These additional taxes are applied to the taxpayer in the form of an assessment. Therefore, HRS § 231-39(b)(2)(A) penalties are an assessed tax that become part of the subject to collection by the Department. Granting the declaratory relief Plaintiff requests will impermissibly interfere with the Department's ability to assess or collect the taxes.

2. The Department's Determination of A Failure To Pay Penalty Pursuant to HRS § 231-39(b)(2)(A) is lawful.

Plaintiff asserts that the Department is unable to assess or collect taxes illegally. See Plaintiff's Opposition at 3. However, Plaintiff fails to explain how the Department's enforcement of its HRS § 231-39(b)(2)(A) penalty is unlawful. Indeed, as demonstrated by the arguments in the Department's Motion, the Director possesses broad statutory authority to impose and enforce penalties. See HRS § 231-3. This authority includes "[m]ak[ing] any assessment [required to be made] by law" and "to be responsible for the collection of all taxes imposed under title 14," except for those designated to the counties. HRS §§ 231-3(1) and 231-3(2). To assess and collect taxes, the Department has the power to "examine the books and papers of account of any person for the purpose of enabling the department to obtain all information that could in any manner aid the department in discharging its duties under any tax law." HRS § 231-3(6). The Department is required to "see that penalties are enforced when prescribed by any tax or revenue law of the State (the administration of which is with the scope of the department's duties) for disobedience or evading of its provisions." HRS § 231-3(4). And for HRS § 231-39(b)(2)(A), for a failure to pay tax:

> 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*. (Emphasis added).

Accordingly, the Department is acting pursuant to its statutory authority set forth in HRS § 231-39(b)(2)(A) to impose penalties for the failure to pay taxes.

3. The Administrative Directive is Within the Statutory Authority of the Department.

Plaintiff erroneously asserts that despite the language in HRS § 231-3(9), the Department was required to promulgate rules relating to HRS § 231-39(b)(2)(A). In support of this assertion, Plaintiff argues that (1) the negligence penalty is an understatement of taxes, (2) the Office of the Lieutenant Governor has rules regarding exercising agency discretion, and (3) HRS § 231-10.7 contains an exception to Chapter 91 for temporary rules. See Plaintiff's Opposition at 6-7.

As noted in the Department's Motion, the requirement for the Department to adopt rules is discretionary unless a statute makes rule adoption mandatory. See HRS § 231-3(9). Section HRS § 231-10.6 is an example of a tax statue which expressly requires the Department to promulgate rules for among other things, an understatement of taxes. Plaintiff argues that "the Negligence Penalty under HRS § 231-39(b)(2)(A) falls into this category because it is a penalty for *understating taxes* without good reason." See Plaintiff's Opposition at 6. (Emphasis in the original). However, this argument fails as an understatement of taxes and an underpayment of taxes are not the same conduct. Section 231-39(b)(2)(A) only allows for a penalty for the underpayment of taxes. As such, Plaintiff's argument is unpersuasive.

Plaintiff notes that the Office of the Lieutenant Governor's website is filled with rules regarding agency discretion, however fails to provide this Court with an explanation of which rules apply to this particular case.

Finally, Plaintiff argues that because HRS § 231-10.7 provides an "exemption" to Chapter 91, that Chapter 91 applies to all other statutory sections. Section § 231-10.7, HRS provides "[n]otwithstanding any other law in title 14, chapter 91, or chapter 201M to the

contrary, the department is authorized to adopt any temporary rules as the department may deem proper as provided in this section." However, the inclusion of this "exemption" to Chapter 91 related to the passage of temporary rules does not expressly mandate that the Department promulgate rules related to HRS § 231-39(b)(2)(A). Indeed, because the Department has the authority "[t]o adopt such rules as the department *may* deem proper effectually to carry out the purposes for which the department is constituted and to regulate matters of procedure by or before the department," the requirement to adopt rules is discretionary. (Emphasis added). See HRS § 231-3(9).

4. Consideration Of The HRS § 231-39(b)(2)(A) Penalty Is Not Limited To The Information On The Returns.

Plaintiff's argument that the Department exceeded its statutory authority because the HRS § 231-39(b)(2)(A) negligence penalty for a failure to pay is limited to the information the taxpayer placed on its return or a failure to file return is wrong. See Plaintiff's Opposition at 4. Indeed, a comparison of the subsections of HRS § 231-39(b)(2)(A) through HRS § 231-39(b)(2)(C) demonstrates that the information on the return is only relevant where the underpayment is due to fraud:

* * *

> (2) Failure to pay tax.
>
> (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.
>
> (B) If any part of any underpayment of tax *required to be shown on a return* is due to fraud, there shall be added to the tax an amount up to fifty per cent of the underpayment as determined by the director.
>
> (C) If any penalty is assessed under subparagraph (B) (relating to fraud) for an underpayment of tax which is *required to be shown on a return*,

> no penalty under paragraph (1) (relating to failure to file the return) shall be assessed with respect to the same underpayment.

Emphasis Added. The underpayment penalty pursuant to HRS § 231-39(b)(2)(A) does not contain the same requirement that the information contained in the return is required to be considered. Accordingly, there is nothing in the statute that limits the Department from considering other factors that occur after a return is filed when determining the penalty.

Plaintiff's hypothetical situation regarding a criminal arrest of a motorist for "recklessly" making a left turn is not applicable to the case at hand because it is not analogous to the facts and statutes before this Court. Plaintiff assumes a legal interpretation of a non-existent statute to fit its fictional motor vehicle hypothetical. This Court does not have that same luxury. As the hypothetical is not a comparison of apples to apples, but apples to motor vehicle violations, it should not be relied upon in this case.

B. TAX FOUNDATION IS NOT AN INTERESTED PERSON PURSUANT TO HRS § 91-7.

Plaintiff argues that it has standing as an interested person because "the rights of the public might otherwise be denied hearing in a judicial forum." See Plaintiff's Opposition at 7, ¶ 6. However, as noted in the Department's Motion, disputes regarding the assessment amount as claimed by the Department and the amount claimed by the taxpayer are judicially resolved by the Tax Appeal Court through the procedures set forth in HRS Chapter 232. Taxpayers seeking to contest assessments may do one of the following: (1) appeal the assessment to the taxation board of review; (2) appeal the assessment to the Tax Appeal Court directly; or (3) pay the disputed assessment under protest and file an action in Tax Appeal Court pursuant to HRS § 40-35. Moreover, taxpayers dissatisfied with the decision of the Tax Appeal Court has the right to appeal to the Intermediate Court of Appeals and apply for certiorari to the Hawaii Supreme Court. See HRS § 231-39(b)(2)(A).

C. THE PLAINTIFF FAILS TO CURE THE FOUNDATIONAL DEFECTS IN ITS EXHIBITS.

Plaintiff's exhibits fail to be supported by the appropriate foundation to be admissible in evidence.

The transcript of the depositions attached to Plaintiff's Motion as Exhibits 4-6 were not properly supported by the certification of the court reporter who prepared the deposition until Plaintiff's Opposition. And while the deposition transcripts are admissible once properly authenticated, the testimony recorded in the deposition transcript is not admissible here because Plaintiff has failed to overcome the Department's objections to the Plaintiff's questions. Simply asserting the evidence comes in as an admission of a party without properly addressing the Department's objections supports exclusion of the exhibits from this Court's consideration.

Similarly, Plaintiff's Exhibit 2 was not authenticated by the Department's witness. Plaintiff fails to overcome the Department's objection to Exhibit 2. The Plaintiff produced Exhibit 2 at the deposition, not the Department. The Department properly objected to Exhibit 2 for lack of foundation which Plaintiff failed to cure. Moreover, Plaintiff failed to lay the proper foundation for introduction of the exhibit and such, it cannot support Plaintiff's Motion.

With respect to Exhibit 7, Plaintiff's assertion that Court records can be judicially noticed is correct. However, the Plaintiff fails to demonstrate that the exhibit is relevant to the instant case, and indeed, admits Exhibit 7 is immaterial to the case. See Plaintiff's Opposition at 10. Accordingly, this exhibit must be stricken.

III. **CONCLUSION**

Based on the foregoing reasons and authorities, and those in its Motion, the Department respectfully requests that its Motion be granted and that Plaintiff's Complaint for Declaratory Judgment be dismissed.

DATED: Honolulu, Hawaii, December 16, 2024.

/s/ Janine R. Udui
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DEPARTMENT OF TAXATION,
STATE OF HAWAII

IN THE CIRCUIT COURT OF THE FIRST CIRCUIT

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In re DEPARTMENT OF TAXATION, ADMINSTRATIVE DIRECTIVE NO. 2021-01. TAX FOUNDATION OF HAWAI'I, a Hawai'i nonprofit corporation, Plaintiff, vs. DEPARTMENT OF TAXATION, STATE OF HAWAI'I, Defendant.	CIVIL NO. 1CCV-24-0000661 CERTIFICATE OF SERVICE

CERTIFICATE OF SERVICE

The undersigned certifies that on December 16, 2024, a copy of the foregoing was duly served on the following party/parties via the Hawaii State Judiciary Electronic Filings and Service System (JEFS) as indicated on the corresponding Notice of Electronic Filing:

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DATED: Honolulu, Hawaii, December 16, 2024.

/s/ Janine R. Udui
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