Court Clerk: Court is now in session. You may be seated. Calling case number 3 on the calendar, MCCB-24-000661, in name, Department of Taxation and Administrative Director, case 21-01. Defendant, Department of Taxation, is welcome to dismiss.

Judge: Counselor, please proceed.

Mr. Tom Yamachika: Good afternoon, Your Honor. Tom Yamachika for the Tax Foundation.

Judge: Good afternoon.

Mr. Nathan Chee: Good afternoon, Your Honor. Nathan Chee for the Attorney General on behalf of the Department of Taxation. At the last hearing I had Deputy Udui here. She had a personal emergency and could not appear today, so I'm appearing in instead.

Judge: All right. Thank you, Mr. Chee. I hope Ms. Udui is okay. We have the Tax Foundation's motion for summary judgment, and then we have the Department of Taxation's motion to dismiss. Mr. Yamachika, where would you like to start? Court does have its inclinations, and I'm happy to share those with you. If you want to direct your arguments, or however you wish to proceed.

Mr. Yamachika: I think logically we should start with the Department's motion to dismiss. If Your Honor wishes to share some proclivities that we can focus our argument around, that would be great too.

Judge: Okay. Court's inclination is to grant the motion to dismiss. Court does think that this is a controversy with respect to taxes, and I'm happy to go into that a little bit further. Mr. Yamachika, I'll ask you to, if you want me to, I did look at the Tax Foundation v. State case 144 Hawaii 175, and the Ocean Resort Villas Vacation Owners case 147 Hawaii 544 to come to the conclusion that this case does involve a controversy with respect to taxes. You care to address that?

Mr. Yamachika: I'll be happy to, Your Honor. This case challenges not a particular taxpayer's liability or lack thereof. It doesn't seek a refund on behalf of anybody, but it's challenging the adequacy of a procedure internally adopted by the Department, intended perhaps just for its employees, which we contend contains misinformation. Now, this specific kind of case was brought up and discussed extensively in a case that we cited in our reply memorandum called Cohen v. United States.

That was the in-bank case decided by the DC Circuit, and it involved whether an IRS procedure could be attacked under the Federal Administrative Procedure Act in light of the Federal Anti-Injunction Act and the Federal Declaratory Judgment Act, which work like Hawaii's, and which, **[unintelligible 00:03:46]** with the Cohen case, our Supreme Court in the Tax Foundation case specifically said, "We are persuaded by the Cohen court's reasoning, and we're going to follow it."

Now, like I said, Cohen [sound cut] was an Administrative Procedures Act case among other counts, and it was directed at a particular refund procedure that the IRS adopted with regard to the telephone excise tax that was declared illegal by almost all of the Federal Circuits around the 2005-2006 time frame. What the IRS did was they sent a notice basically saying, "All right, if you guys want to get some of your money back, here is what you have to do," and they spelled out chapter and verse. The plaintiffs tried to attack the procedure on the grounds that it was substantively inadequate, and that it was a rule within the Federal Administrative Procedure Act, like our case is.

The question was close. It was a 6 to 3 in the DC Circuit and Bank. There was, in the case before, again, it was a divided panel opinion. I certainly think that there are arguments on both sides, but I was looking at the Cohen case just before we got here today, Your Honor. There is an extensive analysis by the DC Circuit's and Bank majority opinion that goes through the entire historical context of their act. The Federal Anti-Injunction Act is very, very old, dating to the 1870s or something like that, but they said, "Well, this case, it involves taxes. It's against the IRS, but it doesn't involve anybody's particular taxes. Nobody is going to get a refund or pay more tax as a result of the outcome in this one case."

On that basis, they concluded this is not a suit that restrains the assessment or collection of taxes, and that there was jurisdiction in the Federal Courts to proceed with the challenge. I don't know what happened on the merits because the in-bank court was limiting its opinion specifically to jurisdiction, but it said, "There is jurisdiction. We can review the IRS's procedure, and we're going to do it." I think it's very important here to note that we need checks and balances.

We need to have the expressed or implied public law and the secret law reviewable by the courts on behalf of our citizenry who bears the brunt after the court does its work. Certainly, we want to make sure, and I think everybody wants to make sure that they do their job lawfully, and they're not doing things that the law doesn't allow, that they're not following a procedure that the law doesn't allow. Because the same argument could be used for anything the department does, really. There is no exception to the Hawaii Administrative Procedure Act for this department. It applies to all agencies.

Judge: Mr. Yamachika, I guess the thing I saw in this case is while you say that there isn't a case involving an individual where this, let's see, negligence, the failure to respond, bullet point, of the negligence penalty, but presumably there is someone that has been aggrieved by that, right? Aren't you able to intervene in such a case? I think I saw somewhere in your papers that when the department assesses the negligence penalty case, they don't break it down per this memo. As I understand, I know you're challenging all of the bullet points, but the number one issue that you have is that failure to respond timely. Again, I understand that you don't know of an aggrieved taxpayer at this point, but someone must have been or will be assessed that penalty in the future. Aren't you able to intervene in that case and make the argument?

Mr. Yamachika: No, we're not, Your Honor.

Judge: Why is that?

Mr. Yamachika: If it's involving an individual taxpayer or a individual company, there are specific statutory procedures that apply to the assessment. They have to go to Tax Appeal Court. This court will never see it.

Judge: Right. This court won't because, I don't think this court has jurisdiction, but Tax Appeal Court does have jurisdiction.

Mr. Yamachika: Tax Appeal Court has jurisdiction in very limited circumstances. If you look at I think 232-19, the jurisdiction of the Tax Appeal Court is to render basically a numerical judgment. When a taxpayer says, "We only owe this much," and the department says it's a different number, the Tax Appeal Court's supposed to come up with a number of what the taxpayer actually owes. It really doesn't have jurisdiction to go further than that. The same argument was raised in the Tax Foundation case. I think we made the point there that we really didn't have any place to go to to challenge the distribution of the county surcharge funds once they had gone into the department's coffers. Certainly that challenge would not be appropriate in Tax Appeal Court.

Judge: Mr. Chee, do you agree? I think that's the central issue, is I believe Tax Foundation has the right to have this issue decided by a court somewhere. This court thinks that that statute or that case law prohibits, or does not give this court jurisdiction over that issue, but I certainly think they have the right to get that reviewed somewhere somehow.

Mr. Chee: I'm not sure. Actually, I haven't thought about Tax Foundation specifically. I do know that the case that Mr. Yamachika referred to in one of his moving papers, he's the counsel of record, and he absolutely could make all of these arguments in that appeal. Any person who has been assessed this failure to pay penalty, absolutely, they can go to the Board of review, which is an administrative appeal. They can go directly to the Tax Appeal Court.

Judge: He's suggesting to me that Tax Appeal Court does not have within its jurisdiction the jurisdiction to decide. Is that what you're suggesting, Mr. Yamachika?

Mr. Yamachika: Yes, Your Honor. Without a victim-- [crosstalk]

Judge: No, but we're saying there is an aggrieved person. We're all in agreement there is an aggrieved person somewhere, has been, will be somewhere, someone is going to be assessed this penalty. The question is, are they entitled to review of this penalty and entitled to make the arguments that Tax Foundation is making today?

Mr. Chee: I believe that would be Tax Appeal Court.

Judge: Would it be your folks' position? If something happened that there was a person who was assessed this penalty, they go to Tax Appeal Court, and then does AG's office come along and say, "No, you can't challenge that here?"

Mr. Chee: I just want to understand the exact. An individual was assessed the failure to pay tax by the Department of Tax-- [crosstalk]

Judge: The failure to respond timely is the big issue, at least for me, but the negligence penalty.

Mr. Chee: I don't want to get distracted, but the failure to respond condition does not cause any penalty to be inflicted or administered.

Judge: That's what it says in the bullet points.

Mr. Chee: What the bullet point says is if there is an underpayment, the section that-- is that issue here, the 231-39? Hang on one second.

Judge: 39-B2A.

Mr. Chee: B2A-2 is a failure to pay the tax. If any underpayment is due to negligence or intentional disregard, there shall be a penalty up to 25% as determined by the director. What the bullet point, that Tax Foundation is aggrieved by is if you read the entirety of the directive, it lays forth not exhaustive lists like the first four bullet points. It's not an exhaustive list, but it's I think maybe the term is example.

Judge: In fact, that's what I wrote in my notes, are those first four bullet points examples or fact patterns of something that might be, right.

Mr. Chee: In the department's audit to determine if there is a negligent or intentional failure to pay the tax, they can consider, for example, these four things. What the fifth bullet point is saying is the department has to ask before they can impose this penalty, they have to ask for certain information. Then it says a failure to respond to the second request, not the first request, the second request within 10 days, at that point, the department is going to say, "I asked you, do you have a reasonable explanation?" I didn't hear anything, so penalty is imposed," that's all that is.

Judge: You say that's all, but that's pretty significant.

Mr. Chee: Oh, it is. I'm sorry.

Judge: I don't mean to prejudge this because the court just doesn't think it has jurisdiction, but I think he has a point though about that bullet point. It is not. The negligence has to do with negligence in submitting the return, not what happened after he submitted the return. I think they raise a decent point that you guys can't do that, but I don't think this court has jurisdiction to make that determination.

I'm asking you folks is if there is an aggrieved taxpayer, and it turns out nothing else, but he didn't respond timely, and all of a sudden he's deemed to be negligent, and then we assess a penalty because he just didn't respond for twice, where does he get to challenge that? Are you saying Tax Appeal Court would have the right to look at this directive and make that determination?

Mr. Chee: Yes. That is correct. I'm sorry if I was--

Judge: No, not at all. Not at all. Not at all. I think we're all--

Mr. Yamachika: Yes, Your Honor, if I could.

Judge: Absolutely.

Mr. Yamachika: Again, we're presupposing that there is an identifiable victim. 632-6 says the reason why we have the Declaratory Judgment Act is so we don't need a victim.

Judge: Except for controversy with respect to taxes, in which case, then you're going somewhere else.

Mr. Yamachika: There's the sentence after that, Your Honor, also. In 632-1A, it says, "But this remedy shall be allowed in cases of written instruments or regulations," of which I think this is one.

Judge: Mr. Chee?

Mr. Chee: If I may, Your Honor.

Judge: Yes.

Mr. Chee: The Tax Foundation case, in its analysis of 632-1, they did highlight that language when it ultimately concluded that it was not a controversy including involving taxes in the first Tax Foundation case. They must have considered that very language at some point, they block quoted it in the Westlaw opinion and underlined the very words that Mr. Yamachika is referring to. The holding itself admittedly doesn't specifically address the words that Tom just highlighted, Mr. Yamachika, excuse me. They certainly were aware that in the Tax Foundation case, that those words were at issue, and still chose to rule how they did.

Mr. Yamachika: Your Honor, if I may. The validity of a document was not an issue in the Tax Foundation Supreme Court case. The issue was the diversion of 10% of the county surcharge revenue to the state's general fund. Here we have a documented issue, and that's all we're challenging, and we are basically asking this court to make the point that the court just mentioned, and that is this post-return conduct in the middle of an audit years later has nothing to do with negligence.

Judge: The first step though is the jurisdictional issue. The way I'm reading these cases is that they are collecting attacks rightly or wrongly, and this court doesn't have jurisdiction to determine because they're actually collecting this money. Let me make sure I have my language right here. Would it interfere with the government's ability to assess or collect taxes? My belief is yes, it does, and therefore the court doesn't have jurisdiction. Rightly or wrongly, they're collecting that tax, and it's not for this court to say, because this court just doesn't, I don't think it has jurisdiction.

Mr. Yamachika: Again, Your Honor, we would refer you to the DC Circuits and Bank opinion where they considered basically the same question, and they said that the court does have jurisdiction to basically rule on the validity of an IRS procedure, which for the same reason is related to the assessment or collection of tax. That's what the IRS does. It assesses and collects tax.

Again, if there is no remedy here, if we can't find a victim that's willing to come forward and raise the precise question that's being presented here, we really have no check or balance on the authority of the department to say whatever it wants to its people, and have them go after people in whatever pretense, valid or invalid, lawful or unlawful. That's what we're worried about.

Judge: Understood. Then what I would invite you to do, to take it up to people who are a lot smarter than I am and see what they say about it. Court is going to grant the motion to dismiss on the grounds it doesn't have jurisdiction in this case, plaintiff, the Tax Foundation is seeking a declaratory judgment that it's the administrative directive number 2021-01 that's dated April 29, 2021, which is an internal use document in the Department of Taxation.

It sets forth non-public guidance relating to HRS 231-39B2. This directive is Exhibit 1 to the Tax Foundation's complaint in this case. Tax Foundation is seeking to declare that it's invalid because it violates the APA, and further that it's unrelated to that statute. Under HRS 632-1, this court has jurisdiction over declaratory relief cases, except among others cases involving any controversy with respect to taxes to determine if matter is a controversy with respect to taxes.

The relevant inquiry is whether granting the relief would interfere with the government's ability to assess or collect taxes. That is set forth in the Tax Foundation V. State case 144, Hawaii 175, and the Ocean Resort Villas Vacation Owners Association v. County of Maui case 147, Hawaii 544. Court determines that the relief sought by the Tax Foundation in this case would interfere with the state's ability to assess or collect taxes. Therefore, the court does grant the state's motion to dismiss. Mr. Chee, I'll ask you to prepare the order.

Mr. Chee: Thank you, Your Honor.

Mr. Yamachika: Thanks, Your Honor. We are very grateful for Your Honor's expressing the rationale.

Judge: Thank you. We can go off the record. Is there anything else you guys want to say on the record?

Mr. Yamachika: Nothing further.