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CAAP-25-0000002

IN THE INTERMEDIATE COURT OF APPEALS OF THE STATE OF HAWAIʻI

In re DEPARTMENT OF TAXATION, ADMINISTRATIVE DIRECTIVE NO. 2021-01. TAX FOUNDATION OF HAWAIʻI, a Hawaiʻi nonprofit corporation, Plaintiff-Appellant, vs. DEPARTMENT OF TAXATION, STATE OF HAWAIʻI, Defendant-Appellee.	CASE NO. 1CCV-24-0000661 FIRST CIRCUIT COURT HONORABLE KARIN L. HOLMA

APPENDIX

THOMAS YAMACHIKA 3504
TAX FOUNDATION OF HAWAIʻI
735 Bishop Street, Suite 417
Honolulu, Hawaiʻi 96813
Telephone: (808) 536-4587
Facsimile: (808) 536-4588
E-mail: tom@tfhawaii.org

Attorney for Plaintiff-Appellant
Tax Foundation of Hawaiʻi.

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APPENDIX

A. HRS § 632-1

§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.

[(b)] Relief by declaratory judgment may be granted in civil cases where an actual controversy exists between contending parties, or where the court is satisfied that antagonistic claims are present between the parties involved which indicate imminent and inevitable litigation, or where in any such case the court is satisfied that a party asserts a legal relation, status, right, or privilege in which the party has a concrete interest and that there is a challenge or denial of the asserted relation, status, right, or privilege by an adversary party who also has or asserts a concrete interest therein, and the court is satisfied also that a declaratory judgment will serve to terminate the uncertainty or controversy

giving rise to the proceeding. Where, however, a statute provides a special form of remedy for a specific type of case, that statutory remedy shall be followed; but the mere fact that an actual or threatened controversy is susceptible of relief through a general common law remedy, a remedy equitable in nature, or an extraordinary legal remedy, whether such remedy is recognized or regulated by statute or not, shall not debar a party from the privilege of obtaining a declaratory judgment in any case where the other essentials to such relief are present. [L 1921, c 162, §1; RL 1925, §2918; RL 1935, §4220; RL 1945, §9971; am L 1945, c 74, §1; RL 1955, §228-1; HRS §632-1; am L 1972, c 89, §1(a) to (c); gen ch 1985]

B. HRS § 632-6

§632-6 Provisions, remedial. 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. [L 1921, c 162, §6; RL 1925, §2923; RL 1935, §4225; RL 1945, §9976; RL 1955, §228-6; HRS §632-6; gen ch 1985]

C. HRS § 91-1

§91-1 Definitions. For the purpose of this chapter:

"Agency" means each state or county board, commission, department, or officer authorized by law to make rules or to adjudicate contested cases, except those in the legislative or judicial branches.

"Agency hearing" refers only to such hearing held by an agency immediately prior to a judicial review of a contested case as provided in section 91-14.

"Contested case" means a proceeding in which the legal rights, duties, or privileges of specific parties are required by law to be determined after an opportunity for agency hearing.

"Party" means each person named or admitted as a party, or properly seeking and entitled as of right to be admitted as a party, in any court or agency proceeding.

"Persons" includes individuals, partnerships, corporations, associations, agencies, or public or private organizations.

"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. [L 1961, c 103, §1; Supp, §6C-1; HRS §91-1; am L 2017, c 110, §1]

D. HRS § 91-7

§91-7 Declaratory judgment on validity of rules. (a) Any interested person may obtain a judicial declaration as to the validity of an agency rule as provided in subsection (b) by bringing an action against the agency in the circuit court or, if applicable, the environmental court, of the county in which the petitioner resides or has its principal place of business. The action may be maintained whether or not the petitioner has first requested the agency to pass upon the validity of the rule in question.

(b) The court shall declare the rule invalid if it finds that it violates constitutional or statutory provisions, or exceeds the statutory authority of the agency, or was adopted without compliance with statutory rulemaking procedures. [L 1961, c 103, §7; Supp, §6C-7; HRS §91-7; am L 2014, c 218, §3]

E. AD 2021-01

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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.

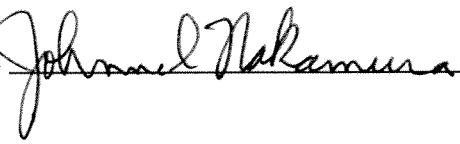
Department of Taxation

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

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 • M-110	September 1, 2019	Tax Announcement No. 2019-02
Fuel tax	• M-20A • M-22 • 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 • 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 • HW-14 • 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 • G-49	July 1, 2020 for periodic returns January 1, 2020 for annual returns	Tax Announcement 2019-16
Transient accommodations tax returns for taxpayers whose annual liability exceeds $4,000	• TA-1 • TA-2	July 1, 2020 for periodic returns January 1, 2020 for annual returns	Tax Announcement 2019-17

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