SCAP-25-0000002

IN THE SUPREME COURT OF THE STATE OF HAWAIʻI

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

**APPELLANT'S APPLICATION FOR TRANSFER TO THE SUPREME COURT OF HAWAIʻI**

**EXHIBIT 1**

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## I. REQUEST FOR TRANSFER TO THE SUPREME COURT

Pursuant to HRS § 602-58(b) and HRAP 40.2, Appellant Tax Foundation of Hawai'i (**Foundation**) requests the Supreme Court of Hawai'i to accept transfer of this appeal.

A nonpublic document, Administrative Directive 2021-01, allows staff of the Department of Taxation (**Department**) to impose a hefty negligence penalty for a reason that is entirely unsupported by the negligence penalty statute and thus unknowable to the taxpayer the penalty is imposed against. The Foundation brought this suit to have the courts invalidate this "secret law," but the Circuit Court held that it was powerless to act because the case is a "controversy with respect to taxes."

This appeal presents a question of fundamental public importance and is an opportunity to resolve apparent confusion in the lower courts. This Court, in *Tax Foundation of Hawaii v. State,* 144 Haw. 175, 188, 439 P.3d 127, 140 (2019), stated that it was persuaded by and would follow the holding in *Cohen v. United States*, 650 F.3d 717 (D.C. Cir. 2011) (en banc), which allowed adjudication of the validity of an IRS Notice governing refund procedure although the IRS objected that it was a "controversy with respect to taxes" and interfered with its collection of revenue. The ICA, in *Booking.com, B.V. v. Suganuma*, No. CAAP-22-0000441 (Haw. Ct. App. May 7, 2025) (Summary Disposition Order copy appended), affirmed a lower court ruling that it had no jurisdiction to review an administrative rule of the Department, reaching a result contrary to *Cohen*. And here, the Circuit Court essentially held that the

Department, unlike any other State department or agency, is immune from judicial review of its administrative rules and other written pronouncements.

The Department wields tremendous power, for, as the U.S. Supreme Court stated long ago, "the power to tax involves the power to destroy; [and] the power to destroy may defeat and render useless the power to create." *McCulloch v. Maryland*, 17 U.S. 316, 431 (1819). In our tripartite system of government, such power cannot go unchecked. There needs to be a way that the Department's administrative determinations, potentially affecting multiple taxpayers, can be reviewed for validity, ideally without needing to impose harm on victims first, to make "the courts more serviceable to the people." HRS § 632-6. Moreover, because the "secret law" that the Foundation challenges is unavailable to the general public, it is nearly impossible for victims of the Department's unsupported interpretation to know or realize that they are victims. The courts must be able to call the executive branch to account in situations such as this.

## II. PRIOR PROCEEDINGS AND SHORT STATEMENT OF RELEVANT FACTS

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" that are not shared with the public. (ROA #68, p. 13.) In response to this request, the Department produced eleven documents out of "about 145" Administrative Directives in total. Administrative Directive (**AD**) 2021-01 was one of the documents produced.

Administrative Directives are "policy pronouncements," as the Department's Special Assistant to the Director of Taxation admitted. Yamashiroya Deposition, 12:8-9 (ROA #68, p. 21). They are issued to give nonpublic guidance to the Department's staff, and Department leadership expects that they will be followed. Yamashiroya Depo., 49:13-51:9 (ROA #96, pp. 14-16).

The Foundation sued for a declaratory judgment and under the Hawaii Administrative Procedures Act to challenge some of the interpretations made in AD 2021-01. AD 2021-01 allows tax auditors to penalize taxpayers for negligence, adding 25% to their tax bill, when the taxpayer has not produced documents or information within the time frame demanded by the auditor. The statute imposing a penalty for negligence, however, requires that the negligence *cause* an underpayment of tax. Conduct after a tax return is filed, such as failure to produce documents on audit, does not cause an underpayment. But the Circuit Court concluded that it lacked jurisdiction because the action was a "controversy with respect to taxes" within the exception in HRS § 632-1(a) and dismissed the suit. The Foundation appealed.

## III. STATEMENT OF POINTS OF ERROR TO BE RAISED

The Circuit Court erred in granting the State's motion for dismissal on the ground that it lacked jurisdiction. This error was preserved in the memoranda supporting the Foundation's motion for summary judgment and opposing the State's motion for dismissal or for summary judgment (ROA ## 67, 95, 102), and during the oral argument on those motions.

## IV. STATUTORY QUALIFICATION FOR TRANSFER

This Court may entertain applications for both mandatory and discretionary transfer of cases from the ICA. Transfer is mandatory when an appeal involves a question of fundamental public importance. HRS § 602-58(a)(1). Transfer is discretionary when an appeal presents issues upon which there is an inconsistency in the decisions of the ICA or of this Court. HRS § 602-58(b)(2).

This appeal is of public concern and importance as it presents the first opportunity in the tax field to validate or strike down "secret law" that is known to the Department but hidden from the public. The California Court of Appeal explained its importance in a sales tax case:

> There is a manifest public interest in the avoidance of secret law and a correlative interest in the disclosure of an agency's working law. The revelation of an agency's working law promotes its accountability to the public and the consistent, predictable and nonarbitrary application and enforcement of the law. This working law is found in the application of an agency's regulations to cases coming before it and in the opinions of its counsel and audit staff training materials which guide the Board's employees in the performance of their duties. It is in the application of a rule to the facts of a case that its meaning is frequently disclosed.

*State Board of Equalization v. Superior Court,* 10 Cal. App. 4th 1177, 1185-86, 13 Cal. Rptr. 2d 342, 347 (1992) (citations omitted). The Department argues for a categorical bar on judicial review. To ensure accountability to the public, that bar cannot be allowed.

This appeal also presents an inconsistency issue. In *Tax Foundation,* this Court approved of the analysis in *Cohen,* a federal case that allowed a challenge under the Administrative Procedures Act to an IRS Notice that

governed how refund claims for illegally collected telephone excise tax were to be processed.

In *Booking.com*, the taxpayer challenged a Department of Taxation administrative rule for validity at the same time it was fighting an assessment of tax based on that rule. The ICA summary disposition order leaves the public and the bar with the impression that APA challenges can never be brought against Department of Taxation administrative rules, contrary to the result of *Cohen*. *Booking.com* instead could have affirmed on the ground that the plaintiff there had "a special form of remedy for a specific type of case," HRS § 632-1(b), and was indeed pursuing it in the Tax Appeal Court.

In this case, the Circuit Court held that the Foundation's suit needed to be dismissed even though *Cohen* and related federal law,[1] *see, e.g., Hibbs v. Winn,* 542 U.S. 88 (2004), allow "third-parties trying to contest the validity of a tax or to stop its collection" to proceed despite the tax exception in the Declaratory Judgment Act. *Cohen,* 650 F.3d at 726; *Hibbs,* 542 U.S. at 104.

The Foundation respectfully asks this Court to take this case to clear up the confusion and hold that interested persons may seek a declaratory judgment as to the validity of a rule or regulation, even in the tax area, so that judgment "will actually serve to uphold the legislature's intent in the … area."

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[1] HRS § 632-1 was amended to mirror the tax exception in the federal Declaratory Judgment Act, so federal law is relevant to interpret the Hawaii tax exception. Tax Foundation, 144 Haw. at 187, 439 P.3d at 139.

*Asato v. Procurement Policy Board,* 132 Haw. 333, 345, 322 P.3d 228, 240 (2014).

## V. CONCLUSION

For these reasons, this appeal qualifies for either mandatory or discretionary transfer under HRS § 602-58. The Foundation respectfully requests that this Court grant its application for transfer.

DATED: Honolulu, Hawai‘i, June 16, 2025.

/s/ Thomas Yamachika
THOMAS YAMACHIKA
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**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that a true and correct copy of the foregoing document will be served on counsel of record indicated below through JEFS upon the filing hereof:

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**Department of Taxation, State of Hawai‘i**

DATED: Honolulu, Hawai‘i, June 16, 2025.

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