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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

APPELLANT'S REPLY BRIEF

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APPELLANT'S REPLY BRIEF

This case is about whether the Department of Taxation can create, and then enforce, secret law.

The Department's staff is told to punish people for violating standards that are **not** in any published rule or statute, and are not likely to be known by normal people, because the standards are in a document "for internal use only." This case presents the question of whether the courts can do anything about it. The Department says that courts can only act when a person punished (1) knows about these unpublished internal standards, (2) can prove that the punishment resulted from breaching them, and then (3) perfects a timely tax appeal. Reliance on such an exceedingly rare confluence of events cannot be the right answer.

The Department protests that having the Judiciary uphold the rule of law in any tax-related case, including this one, would be bothersome. That it would interfere with the collection of revenue. But any attempt whatsoever to check and balance the Department could be seen as bothersome as well. That is why *Cohen v. United States,* 650 F.3d 717 (D.C. Cir. 2011) (en banc), held that a group of taxpayers could properly ask the Judiciary to determine the validity of an IRS procedure that allegedly limited refunds of overcollected taxes. The Department distinguishes the case on the basis that the taxes there already had been collected, so the challenge could not impede revenue collection. The distinction is without substance; bringing money in the door

and preventing that money from going out again as refunds are literally two sides of the same coin.[1]

HRS § 91-7 provides a clear jurisdictional basis with no exception for the Department or for taxes. It says that "[a]ny interested person may obtain a judicial declaration as to the validity of an agency rule … by bringing an action against the agency in the circuit court … of the county in which the petitioner resides or has its principal place of business." The Department argues that the statute confers venue but not jurisdiction. However, *Hawaii Home Infusion Associates v. Befitel,* 114 Haw. 87, 157 P.3d 526 (2007), held the opposite. There, the dispositive issue was whether HRS § 91-7 "(1) endows the … circuit court with subject matter jurisdiction … or (2) merely expands the general venue rule set forth in HRS § 603-36(5)," *id.* at 91, 157 P.3d at 530, and the court decided on the former.

The Department also contends that AD 2021-01, the Administrative Directive at issue here, is not a "rule" within the meaning of the Hawaii Administrative Procedures Act so that HRS § 91-7 does not apply at all. However, the Department's witness admitted that the directive was a statement of policy that its staff was expected to comply with. The directive concerned imposition of penalties upon taxpayers, which obviously affects private rights. The directive is a rule within the meaning of HRS § 91-1 and may be reviewed

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[1] In many tax controversies, the taxpayer has the option of either challenging a tax assessment or paying the tax under protest and claiming a refund. HRS §§ 40-35, 232-14.5, 235-114, 237-42.

as such. *Green Party of Hawaii v. Nago,* 138 Haw. 228, 237-38, 378 P.3d 944, 953-54 (2016); *Ainoa v. Unemployment Compensation Appeals Division,* 62 Haw. 286, 614 P.2d 380 (1980).

In the federal government, the courts have made clear that "an agency will not be permitted to develop a body of 'secret law,' used by it in the discharge of its regulatory duties and in its dealings with the public, but hidden behind a veil of privilege[2] because it is not designated as 'formal,' 'binding,' or 'final.' The theme was sounded as early as 1971 when the court emphatically stated that agencies would be required to disclose 'orders and interpretations which it actually applies to cases before it,' in order to prevent the development of 'secret law.'" *Coastal States Gas Corp. v. Department of Energy,* 617 F.2d 854, 867 (D.C. Cir. 1980).

These sentiments were echoed in the tax context in California, where the Court of Appeal stated:

> 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. (See *NLRB v. Sears, Roebuck & Co.* (1975) 421 U.S. 132, 153, 95 S. Ct. 1504, 1517, 44 L. Ed. 2d 29, 49; *Citizens for a Better Environment v. Department of Food & Agriculture* (1985) 171 Cal. App. 3d 704, 714, fn. 7, 217 Cal. Rptr. 504.) 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. (See *CBS, Inc. v. Block* (1986) 42 Cal. 3d 646, 651, 230 Cal. Rptr. 362, 725 P.2d 470.) 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

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[2] The federal government recognizes a "deliberative process privilege" which the Hawaii Supreme Court has stated does not apply in Hawaii. Peer News LLC v. City & County of Honolulu, 143 Haw. 472, 431 P.3d 1245 (2018).

> 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).

Secret law needs to be exposed, and its validity needs to be judged. The Foundation is actively working on the first part, and we respectfully ask the Judiciary to do the second.

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

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

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