April 10, 1935.

OPINION NO. 1615

TAXATION, GENERALLY; EXEMPTION.

Section 1978, R. L. 1935 (Act 95, L. 1927) exempts from all property taxes, for a period of ten years, all property actually and solely used in the construction, operation or maintenance of any water system, operated for the purpose of supplying water to the general public.

TAXATION, PUBLIC UTILITIES; NATURE OF TAX.

Chapter 69, R. L. 1935 levies an excise tax upon such gross income of a public utility as is derived from its public utility business.

TAXATION, GENERALLY; NATURE OF TAX ON GROSS INCOME.

Although a tax upon gross income may be deemed an excise tax it may also be considered a property tax.

TAXATION, PUBLIC UTILITIES; EXEMPTION.

The tax upon gross income derived from a public utility's property, levied by said Chapter 69, is a tax upon the property producing the income, and the company, if of the nature specified in said section 1978, is exempt from the payment of the tax to the extent that its gross income is derived from property actually and solely used in the construction, operation, or maintenance of any water system operated for the purpose of supplying water to the general public.

STATUTES; CONSTRUCTION AND OPERATION.

The intention to grant an exemption must be expressed in clear and unmistakable terms, for it is a well-settled principle that, when an exemption is claimed under a statute, it is to be construed strictly against the property owner and in favor of the public.

Mr. Harold C. Hill,
Deputy Tax Commissioner,
Honolulu, T. H.

Sir:

From your letter of March 8th we understand that the Kohala Ditch Company, Limited, a public utility within the meaning of that term as defined in section 7940, R. L. 1935, operates a water system for the purpose of supplying water to the general public. You wish to be advised as to whether the company is subject to the tax levied by Chapter 69, R. L. 1935.

Act 95, L. 1927 (section 1978, R. L. 1935) provides as follows:

"Section 1. Section 1330 of the Revised Laws of Hawaii 1925, is hereby amended so as to read as follows:

"'Section 1330. Water systems. For the term of ten years from and after the first day of January, 1928. all *property* actually and solely used in the construction, operation and/or maintenance of any water system, including therein water, water-rights, ditches, flumes, canals, tunnels, pipes, reservoirs, water-gates, and all other means of storing and distributing water for irrigation, agricultural or domestic purposes, owned or operated by any person or corporation for the purpose of supply water to the general public shall be exempt from the payment of all *property taxes.*'"

The terms of the exemption are clear. All property actually and solely used in the construction, operation, or maintenance of any water system, operated for the purpose of supplying water to the general public, is exempt from the payment of all *property taxes.*

Hence, upon the enactment of Act 95, all property of the Kohala Ditch Company, Limited, actually and solely used in the construction, operation or maintenance of a water system was exempted from the payment of all property taxes.

Thereafter Act 42, 2nd Sp. S. L. 1932, (Chapter 69, R. L. 1935) was enacted. Section 2140 of said chapter 69 provides:

"Sec. 2140. Public utility tax. In lieu of all taxes other than income taxes, the specific taxes imposed by chapter 70, and the fees prescribed by chapter 261, and any tax specifically imposed by the terms of its franchise, there shall be levied and assessed upon each public utility a tax of such rate per centum of its *gross income* each year from its public utility business as shall be determined in the manner hereinafter provided."

Section 2143 of said chapter provides in part:

"The rate of the tax upon the *gross income* of any public utility for the purposes of this chapter shall be determined as follows: * * *"

The statute imposes an excise tax upon gross income. Not only does this appear from the statute, but it also appears from the Senate report. The report states:

"At the present time public utilities are taxed under the general property tax law as enterprises for profit, particularly under sections 1315 and 1320 of the Revised Laws of Hawaii 1925, in addition to franchise taxes and income taxes. The proposed law levies a tax of six percent on the *gross profits* of the corporation in lieu of the real and personal property tax." (Senate Journal, Second Special Session, 1932, page 34.)

Although, in one sense, the tax is an excise tax on the privilege of doing business in the Territory, *Maine v. Grand Trunk R. Co.*, 35 L. Ed. 994, *Security etc. Bank v. District of Columbia*, 279 Fed. 185, *Ohio River & W. R. Co. v. Dittey*, 203 Fed. 537, it may also be considered a tax upon property.

In the case of *Oahu R. & L. Co. v. Pratt*, 14 Haw. 126, it appears that, in a contract between the Minister of the Interior and the Oahu R. & L. Co., it was agreed "that no taxes shall be levied by the Hawaiian Government for the period of twenty years upon the property of the party of the second part, which shall be fairly necessary to the reasonable construction, maintenance and operation of the said steam railroad * * *". Thereafter, the income tax law of 1901 was enacted, and the question was propounded to the Supreme Court as to whether the Oahu R. & L. Co., was wholly exempt from taxation on its income. The Court said in part:

"2. It is contended on behalf of the defendant that income is a separate and distinct thing from the property from which it is derived and that although the exemption includes all property 'fairly necessary to the reasonable construction, maintenance and operation' of the road, it does not follow that the income from such property is exempt and cannot be taxed. This contention may be ingenious but it can scarcely be considered sound. It is not material to the determination of the question presented whether or not the income and the property producing the income are one and the same thing. "The real question is whether or not a tax on the income is a tax on the property from which the income is derived. If this last question be answered in the affirmative, the income produced from exempt property is clearly within the exemption. This ought not at this time to be regarded as an open question. The Supreme Court of the United States in *Pollork v. Farmer's Loan & Trust Co.,* 157 U. S. 429, said: The real question is, is there any basis upon which to rest the contention that real estate belongs to one of the two great classes of taxes and the rent or income which is the incident of its ownership belongs to the other? We are unable to perceive any ground for the alleged distinction. An annual tax upon the annual value or annual user of real estate appears to us the same in substance as an annual tax on the real estate, which would he paid out of the rent or income.' At p. 581.

"Again on the rehearing of said cause Chief Justice Fuller speaking for the court said that a tax on the income from real estate 'fell within the same class as the source whence the income was derived, that is, that a tax upon the realty and a tax upon the receipts therefrom were alike direct.' 158 U. S. 618.

"In a later case the same court held 'that a stamp tax on a foreign bill of lading is in substance and effect equivalent to a tax on the articles included in the hill of lading.' *Fairbanks v. United States,* 181 U. S. 283, at p. 312. In the opinions in this last case there is an exhaustive review of the many decisions on this interesting subject.

"In the light of these decisions it is clear that a tax on the income derived from exempt property would be in 'substance and effect' a tax on *the property* producing the income and a violation of the terms of the contract, existing between plaintiff and the Government of Hawaii, exempting such property from all taxes for a term of twenty years. It follows that an affirmative answer must he returned to question numher 2."

The *Oahu R. & L. Co.* case is applicable to the facts involved in your question, and, we feel that it must be followed. In the light of that decision a tax on the gross income derived from the company's property would be a tax on the property producing the income. Being in the nature of a tax upon the property, said section 1978 would apply, and the company, to the extent that its gross income was received from "property *actually* and *solely* used in the construction, operation or maintenance of any water system" operated for the purpose of supplying water to the general public, would be exempt from the payment of the tax. Income from other property would not be so exempt. See also: *Pullman Co. v. Richardson,* 197 Pac. (Cal.) 346; *State v. Northwestern Tel. Exch. Co.,* 120 N. W. (Minn.) 534; *United States Exp. Co. v. Minnesota,* 56 L. Ed. 459; *Cudahy Packing Co. v. Minnesota,* 62 L. Ed. 827.

Other courts have decided that merely because certain of a company's property was exempt from a property tax would not cause its income to be exempt from an income tax. 4 Cooley on Taxation, p. 3491, sec. 1760; *Ludlow-Saylor Wire Co. v. Woolbrink,* 205 S. W. (Mo.) 196. As hereinbefore pointed out the territorial Supreme Court has decided this question to the contrary.

Very serious doubt exists as to whether the Legislature had or has the power, under section 55 of the Organic Act, to grant any exemptions from taxes. We hope to make this question a matter for judicial determination at an early date. Until then we feel that the Legislature's intention should be followed.

Respectfully,

J. V. Hodgson,
First Deputy Attorney General.

APPROVED:

W. B. PITTMAN,
Attorney General.