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TAX APPEAL COURT
STATE OF HAWAII
FILED
SEP 14 2 59 PM '89
RUPERT K. CHUN
REGISTRAR

IN THE TAX APPEAL COURT OF THE STATE OF HAWAII

In the Matter of the Tax Appeal)	CASE NOS. 2486 and 2497
)	
of)	FINDINGS OF FACTS AND
)	CONCLUSIONS OF LAW AND
MTL, INC.)	DECISION AND ORDER;
)	CERTIFICATE OF SERVICE
)	
)	
)	Hearing Date: May 5, 1989
)	Judge: Robert G. Klein

FINDINGS OF FACTS AND CONCLUSIONS OF LAW

This consolidated matter came before the Honorable Robert G. Klein for oral argument on May 5, 1989 pursuant to the State of Hawaii's appeals from the decisions of the Oahu Tax Board of Review. Having considered all the evidence presented at the hearing in this action by stipulation, and the oral and written arguments, the Court finds the facts to be as follows:

A TRUE COPY, ATTEST WITH
THE SEAL OF SAID COURT.

BARBARA E. WRIGHT

Deputy Registrar

FINDINGS OF FACT

1. If it should be later determined that any of these findings of fact should be properly deemed conclusions of law, the Court so concludes on those legal issues.¹

2. This case concerns the assessment by the State of Hawaii of the state general excise tax upon the funds provided to MTL, Inc. for the operation of the bus system of the City and County of Honolulu. The excise tax was assessed in the amounts of \$193,596.63 (for the period from July 1, 1981 to June 30, 1985,) and \$1,577,009.70 (for the period from August 1, 1985 to June 30, 1986.)

3. MTL, Inc. ("MTL") is a private corporation incorporated in Hawaii in 1971.

4. The City and County of Honolulu (hereinafter "City") is a political subdivision of the State of Hawaii. The City is empowered by the provisions of Chapter 51, H.R.S. to purchase, construct and operate a mass transportation system within the City and County of Honolulu.

5. Pursuant to Chapter 51, H.R.S., the City has entered into management agreements with MTL (hereinafter "City-MTL Management Agreement") to provide public bus service for the City and County of Honolulu and to operate and manage the City's bus system since February 25, 1971.

¹This is an acknowledgement that at times it is impossible to state a finding of fact that is not unwieldy without making some conclusion of law.

6. Prior to 1971, bus service in Honolulu was furnished by three private bus companies, the largest of which was Honolulu Rapid Transit Company ("HRT"). HRT was struck by the Teamsters Union in 1971. As a result, the City was without bus service for a prolonged period. In order to maintain much needed public transit services, the City acquired HRT's rolling stock and fixed facilities by applying to the Urban Mass Transportation Administration ("UMTA") for financial aid to assist the City in its acquisition, which UMTA was willing to provide.

7. The strike presented the City with a number of complex but serious issues in connection with the acquisition, to wit:

- (a) the City operated under two public employee units, HGEA and UPW, but past actions by the State Legislature had not provided specific categories within either the civil service system or within the government union contracts to cover bus operators and bus maintenance employees;
- (b) HRT bus employees were covered by a contract with the Teamsters Union and had certain pension rights which were not transferable to the municipal government;
- (c) Section 13(c) of the Urban Mass Transportation Act of 1964 as amended, required that any acquisition of the mass transit system with federal assistance must preserve and protect the existing rights of

employees covered by a collective bargaining agreement;

- (d) In order to get the necessary money to finance the original and subsequent purchases of the buses, tools and other equipment, the City had to get federal subsidies. Under Section 13(c) of the Urban Mass Transit Act, 49 U.S.C. §1609(c) ("UMTA"), a subsidy could only be obtained if the City signed a Section 13(c) certificate promising that all of the employees' past rights would be protected and that they would lose none of their collective bargaining benefits. Because of the question of past years in service, the problem of "buying into" the public employee retirement system arose if the existing employees were not to suffer a loss of benefits. The City was then caught in a bind for if it did not form a private corporation, it would have to take all of the employees of HRT into the public employee retirement system, and the required pension fund contribution would have cost tens of millions of dollars. It also had the problem that under the state's collective bargaining law there was no unit for the HRT employees and the City would not engage in collective bargaining. Since it was not able to do these and yet it needed UMTA funds to make the purchases of the buses, etc., the City

encouraged the formation of MTL to act as the employer so that the employees of MTL would not be employees of the City and therefore not entitled to be placed into the public employee retirement system. The City would avoid paying a pension fund contribution estimated as exceeding tens of millions of dollars and at the same time still qualify for UMTA benefits;

- (e) certain HRT management and administrative personnel were immediately available and experienced. Therefore, in order to facilitate the transition and assure continuity and service, the City encouraged them to form a private corporation to operate the bus service as TheBus service on a not-for-profit basis.

8. MTL was intended to act as a private corporation for the reason of fulfilling the City's mandate to purchase, construct and operate a mass transportation system within the City and County of Honolulu.

9. Under an agreement pursuant to Section 13 of the Urban Mass Transit Act, as amended (hereinafter "13(c) Agreement"), both the City and MTL agreed to be bound by the terms of the collective bargaining agreements reached between MTL and the Teamsters Local 996.

10. MTL'S collective bargaining unit employees are members of the Teamsters, not the public employee unions, as

determined by HGEA v. Hamada, Civil No. 53212. Wages, rates of pay and grievances are governed by the Collective Bargaining Agreement between MTL and Local 996, Teamsters and Allied Workers.

11. The City owns all the properties and facilities of the transit system operated by MTL, including the buses, real estate facilities, parking garages, fuel pumps, dispatching office, machinery for maintaining the buses, office supplies, etc. The City provides such real and personal property free of charge to MTL for use in operating the City's bus system, including all of said properties and facilities of the City's public transit system, tools and machinery, gasoline, fuels, lubricants, tires and tubes, parts and "materials as required for the operation of the public transit system" under the City-Management Agreement. MTL pays no fees to the City for the use of said facilities or properties.

12. The approved budget for year-end June 30, 1988 for the City's bus system was approximately \$62.6 million.

13. The sources of those funds were as follows. At then-current fare levels, approximately \$18.8 million was generated in 1988 in the form of system operating revenues,² leaving approximately \$43.7 million which had to be funded in 1988 through subsidies, federal or City. The Federal Government subsidized

² All operating revenues (or bus receipts) generated from the operation of the City's bus system, including bus fares, car card advertising, prepaid bus passes, and revenue derived from the rental or use of or investment of the City-owned property used in providing public transportation, are and remain the property of the City as of the time of their receipt. This operating revenue has not been and is not treated by the Department of Taxation as taxable gross receipts to MTL.

approximately \$3.5 million of operating expenses, leaving a 1988 City subsidy requirement of approximately \$40.2 million. This City subsidy has been and continues to be primarily funded through property taxes and county fuel taxes in the City and County of Honolulu.

14. The uses for those funds are as follows. The City is obligated under the City-MTL Management Agreement to provide MTL upon presentation of invoices all of MTL's operating expenses incurred in the operation of Honolulu's public mass transit system. The City pays MTL for all its monthly operating and maintenance expenses, primarily for salaries, wages and fringe benefits. Thus, ultimately the City pays for MTL employees' medical and dental plans, group life insurance and retirement benefits. In fiscal year 1988, the City's payment to MTL for all items amounted to \$43.67 million. It is basically upon this amount that the State imposes the general excise tax.

15. The remaining use for those funds is the City's own direct purchases of tools and machinery, tires, fuel, lubricants, parts, etc. described earlier. In 1988, the City's purchases totalled approximately \$18.9 million.

16. Until now, the State Department of Taxation has throughout MTL's 19-year history refrained from taxing those items paid for by the City directly, such as tires, fuel, motor vehicle parts, maintenance and repair parts and equipment.

17. Since the inception of the City's bus system, the City has had to underwrite yearly shortfalls in sources of funds

which operating revenues and federal operating subsidies cannot cover.

18. The Director of Taxation does not assess the general excise tax upon the operating revenues of the City's bus system, but does assess the general excise tax against all of the monies paid by the City to MTL under the City-Management Agreement. These amounts taxed comprise all of MTL's expenses for salaries, wages and fringe benefits, and other operating and maintenance costs.

19. The City's payment to MTL pursuant to contract includes an amount to reimburse MTL for the general excise tax assessed by the Director of Taxation upon MTL.

20. The City finances its reimbursement of MTL's salaries, wage and benefits and other operating and maintenance expenses, including the payment of the general excise tax, primarily out of the County Real Property Tax.

21. MTL as a private corporation operates on a not-for-profit basis and, since its inception, has not earned corporate profits.

22. MTL has never paid state or federal net income taxes because its total deductions have always equalled its gross receipts, leaving it with no taxable income.

23. MTL has not earned a profit from passenger fares, but has operated a subsidized public mass transit system for the City and County of Honolulu that services the community at subsidized fares which are by design less than the true economic cost of the services provided.

24. MTL was formed to engage in activities which did not have as its object gain or economic benefit, direct or indirect.

25. Except for labor relations such as negotiations of the MTL-Teamsters contract, personnel policies or employer-employee matters, and except for day-to-day operations of the bus, the City exercises substantial management control over virtually all other aspects of MTL's operation, to wit: the City is responsible for development of transit policy, service planning, routes and fares, grants and administration, and oversight of MTL's service and management contract, and provides support services in areas of finance, purchasing, risk management (insurance, including when the City chooses to self-insure MTL activity), data systems, communications, budget analysis, procurement plans for major items such as rolling stock and facilities and purchase processing. MTL must develop in advance a draft budget in the same format as other City departments, which is subject to the same constraints and controls regarding the lawful expenditure of public funds as any public sector department or agency. Any deviation from the approved budget requires a formal request and approval from the City, including its applicable officials. Ultimately, the City Council must approve the budget, and conducts an independent inquiry into the reasonableness of expenses incurred and the overall justification for the budget.

26. The City, by ordinance, prescribes the fares to be charged passengers on its buses.

27. The executive management salaries of MTL are tied under the City-MTL Management Contract to comparable City salary levels. From 1971 to the present, the MTL contract has set the pay of the chief executive officers (President, Vice-President and Treasurer) of MTL at the same level as a director, first deputy, and SR 31, L4 for the City and County of Honolulu. Throughout the years the compensation has been adjusted upwards at the same time as corresponding City increases.

28. All procurement activity of MTL for most items is under the direct supervision of the City's Director of Finance and follows a formal public competitive procurement system. In certain cases, the City pays directly purchase orders which MTL requests.

29. The annual budget for MTL is prepared and submitted to the City under City rules and regulations for its review and approval. All expenditures thereunder are processed through the City's fiscal control system in accordance with the budget.

30. MTL has not made a counterproposal to the Teamsters Union regarding cost items during negotiations over the collective bargaining agreement without first receiving approval from the City pursuant to the City's budget oversight powers.

31. MTL has conducted no other activity other than the management of the City's bus system and MTL has no other contracts.

32. In addition to the underlying Oahu Tax Appeal Board of Review decision in this case there have been, over the years, a number of federal and state agencies and courts acting as fact-finding tribunals in labor law cases which have, after affording

all parties the opportunity to be heard and to cross examine, made findings of fact consistent with that set forth herein, and which support the determination that ". . . in as much as the City owns all the equipment, exercises significant managerial control, and plays an important role in the negotiation process, and is involved with MTL in the operations, management and functions . . . MTL is an instrumentality of the City." These decisions include NLRB Case NO. 37-RC-2114 dated April 26, 1976; HPERB decision no. 85, dated November 1, 1977 and the decision of the Honorable Robert Won Bae Chang in Civil No. 53212 for the First Circuit Court of the State of Hawaii. Each of these decisions are final and made findings of fact after notice and hearing and the opportunity to cross-examine which findings are substantially similar to that of the Oahu Tax Board of Review in this case dated March 23, 1987 and April 3, 1987.

33. The Hawaii State Attorney General by letter dated November 16, 1987, rendered its opinion that MTL should be treated as a City instrumentality for UMTA's competitive bidding purposes.

34. MTL is used for a governmental purpose and performs a governmental function. MTL was created out of exigent circumstances back in 1971 when, in response to the transit strike, the City and County of Honolulu acquired the properties and assets of HRT.

35. MTL performs its functions on behalf of the City and County of Honolulu. MTL assumed the City's obligations with respect to the mass transit workers in order to assist in

minimizing the cost to the City of the pension fund contribution when operating the City's bus system.

36. The City and County of Honolulu has the powers and interests of an owner, and with the exception of personnel matters, control and supervision of the MTL organization is vested in the City and County of Honolulu, its Department of Transportation Services, and the City budget process.

37. MTL has little if any financial autonomy from the City and County of Honolulu, its source of its operating expenses. MTL is being bankrolled by the City, which will continue for the foreseeable future.

38. MTL has paid, and the State presently holds, general excise taxes paid by MTL in the amounts assessed for reporting periods from July 1, 1981 to June 30, 1985, and August 1, 1985 to June 30, 1986.

39. The Court takes judicial notice that in addition to the instant appeal, MTL has taken subsequent appeals with respect to general excise tax assessments for subsequent periods based on the identical issues determined herein, and which are pending in the Tax Appeal Court, to wit Cases Nos. 2654 and 2655. The Court takes further judicial notice that the parties hereto have entered into a stipulation approved by this Court to consolidate the above cases and to hold them in abeyance pending the outcome in the instant appeal, which is the lead case on the question of whether MTL, Inc. is subject to exemption from the general excise tax.

CONCLUSIONS OF LAW

Based on the preceding Findings of Fact, the Court concludes the following:

1. If it should later be determined that any of these conclusions of law should be properly deemed to be findings of fact, the Court so finds as to those facts.

2. Chapter 51, H.R.S. provides the express or implied statutory authority for the creation of MTL as an instrumentality of the City and County of Honolulu to operate the City's bus system.

3. MTL is an instrumentality of the City for the purpose of operating the City's bus system, and providing public transportation of passengers.

4. Given the unique factual background of MTL specific to this case that leads this Court to conclude that MTL is a City instrumentality, MTL is not a "business" within the meaning of §237-2 H.R.S. and the funds it receives from the City and County of Honolulu is not "gross income" within the meaning of §237-3 H.R.S.

5. MTL is exempt from the general excise tax law under §237-23(a)(3) H.R.S., which provides an exemption for public utilities owned and operated by the City, because MTL is a City instrumentality.

6. Accordingly, the instant consolidated appeals of the Director of Taxation are denied.


DATED: Honolulu, Hawaii, SEP 14 1989.

Robert G. Klein



JUDGE OF THE ABOVE-ENTITLED COURT

APPROVED AS TO FORM:



WARREN PRICE, III.
KEVIN T. WAKAYAMA
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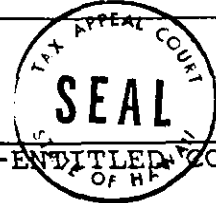
Findings of Fact and Conclusions of Law
In the Matter of the Tax Appeal of MTL,
Inc.; Case Nos. 2486 and 2497

DECISION AND ORDER

Based upon the foregoing findings of fact and conclusions of law, it is hereby ORDERED, ADJUDGED and DECREED that judgment is entered in favor of appellee MTL, Inc.

DATED: Honolulu, Hawaii, SEP 14 1989

Robert G. Klein
JUDGE OF THE ABOVE-ENTITLED COURT



Findings of Fact and Conclusions of Law
In the Matter of the Tax Appeal of MTL,
Inc.; Case Nos. 2486 and 2497


CERTIFICATE OF SERVICE

THE UNDERSIGNED HEREBY CERTIFIES that a copy of the Findings of Fact and Conclusions of Law and Decision and Order will be duly served on the following by hand delivery on September 11, 1989:

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DATED: Honolulu, Hawaii, September 11, 1989.



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