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CASE NO. 1900

IN THE TAX APPEAL COURT OF THE

STATE OF HAWAII

In the Matter of the Tax Appeal of O. W. LIMITED PARTNERSHIP	FINDINGS OF FACT AND CONCLUSIONS OF LAW

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The trial of this case was held November 30 - December 8, 1981. The court, having heard the testimony of the witnesses and reviewed the exhibits and the memoranda of counsel, and being fully advised in the premises, makes and enters the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. The Taxpayer, O. W. Limited Partnership (OWLP), is one of three entities participating in the operation of the Outrigger West Hotel. The partners of OWLP are (1) Hotel Operating Co. of Hawaii, Ltd. (HOCOH), a corporation wholly owned by members of the Kelley Family, (2) Dr. Richard Kelley, and (3) various Kelley family trusts, who in the aggregate hold 99% of the partnership interests. The other 1% of OWLP is held by C. G. Marshall.

2. The other two participants in the Outrigger West Hotel are Hawaii Hotels Operating Co., Ltd. (HHOC) and Waikiki Services, Limited (WS), both of which were 50% owned by the Kelley family during years in question. For the year 1974, Hawaii Hotel Operators, Inc. (HHOI) (owned 99% by Kelley family members) also participated in the Outrigger West Hotel.

3. The chief executive officer of HOCOH, HHOC, WS and HHOI was Dr. Richard Kelley. The other participants in HHOC were Interisland Resorts (W. Dudley Child and affiliates) and Tradewind Tours (Robert McGregor and affiliates). During the entire period in question, various members of the Kelley family, Mr. McGregor and Mr. Child met periodically, generally at weekly luncheon meetings, to discuss operations of the Outrigger Hotels. Dr. Richard Kelley had full responsibility for the day-to-day management of the Outrigger West Hotel.

4. There are four hotels bearing the name Outrigger, the main hotel being the Waikiki Outrigger Hotel. The others are the Outrigger West Hotel, the Outrigger East Hotel and the Outrigger Surf Hotel. All major operational decisions concerning the hotel group are conducted out of one office in the Waikiki Outrigger Hotel. All sales, reservations, marketing and daily management for all four hotels take place at this central office.

5. The hotels deal with the public only in the name of the Outrigger Hotels as a group, or as the Outrigger West, Outrigger East, Outrigger Surf or Waikiki Outrigger Hotel. The public is not aware of the existence of OWLP, HHOC, HOCOH, HHOI or WS.

6. The employees of the hotels are informed that they are working for the Outrigger Hotels as a group, and are generally assigned to a particular hotel. As needs arise, employees may be shifted temporarily to work in others of the Outrigger Hotel group. None of the employees are hired to perform services for OWLP or HHOC; they work for the hotel, which is one of a group of four hotels.

7. OWLP, HHOC and WS signed a joint operating agreement dated December 30, 1974, setting forth various responsibilities for each. The agreement is similar in content to one dated a year earlier. The agreement provided for division of gross receipts at the source among the three, with OWLP receiving 73% of hotel room charges, 100% of shop rentals and 10% to 25% of food, beverage and garage receipts. HHOC received 27% of room charges, and 75% to 90% of food and beverage receipts. WS received 75% of garage charges.

8. During the four years in question, the allocation percentages were changed six times. The purpose and intent behind this allocation mechanism was to provide a return to OWLP of 98% of net income and to HHOC of 2% of net income. The joint operating agreement did not express all details of the arrangement among the participants, but it did set forth how expenses of the hotel were to be charged. In operation, virtually all expenses of the hotel were charged as set forth in the agreement. The several adjustments to the allocation of gross receipts were made to permit each participant to cover the expenses allocated to its account and to receive a net return of approximately the predetermined percentages.

9. In some other areas, the operations of the hotel differed from that provided in the joint operating agreement. Some functions assigned to one participant were not performed by that participant at all, but by employees of the Outrigger West Hotel or the Waikiki Outrigger Hotel or the Outrigger group. All employee performance was under the general direction of Dr. Kelley, no matter whom was assigned the responsibility.

10. Instead of reporting gross receipts as a partnership or joint venture, the Outrigger West Hotel accounted in a unique manner, different from the ordinary business method of a joint enterprise sharing profit and loss. Each day, one employee, who was stationed at the Waikiki Outrigger Hotel, went to various collection stations at each of the four Outrigger hotels. She picked up daily receipts and accounting sheets. Upon return to her office, she allocated the receipts from the hotels into several accounts. For the Outrigger West Hotel, receipts from rooms were allocated from 55% to 100% to OWLP and deposited to its account, during various of the six periods during the four years in question. The remaining room receipts were deposited to the account of HHOC. Similarly, receipts from food and beverage were deposited to the HHOC account (70% to 90%) with the balance to the OWLP account. HHOC and OWLP each reported and paid general excise taxes on all amounts deposited to their respective accounts. Thus, 100% of the gross receipts of the Outrigger West Hotel were reported for general excise tax purposes and the taxes paid thereon.

11. Considering the written joint operating agreement and the actual method and manner of the operation

of the Outrigger West Hotel during the years in question, it is clear that 0WLP and HHOC intended to, and did establish joint control of the business venture known as the Outrigger West Hotel, and a sharing of the profits thereof. The operation was a joint venture among OWLP and HHOC.

12. On November 10, 1980, the Director of Taxation assessed OWLP in the amount of $146,997.91 plus $47,755.84 interest, or a total of $194,753.75 additional general excise taxes for the four years 1974-77. The explanation in the notices was "underreported room rentals." The taxpayer paid the amount assessed on December 18, 1980 and filed notice of appeal to this Court the same day.

13. The "underreported room rentals" for which the Director assessed the additional taxes were those actually allocated to and reported by HHOC. The Director's position is that OWLP had to report 100% of room rentals and pay the taxes thereon, and HHOC also had to report and pay the taxes on 25% of the same room rentals, as its receipts for "services performed" for OWLP. The Director conceded that if HHOC and OWLP were transacting the hotel operation as partners or joint venturers, the assessment would not have been made.

14. The operation of the Outrigger West Hotel was a unified business. OWLP and HHOC were not conducting separate operations but were operating the hotel jointly as a joint venture. They correctly reported and paid general excise taxes on 100% of the receipts of the hotel from rooms, shop rentals, food and beverages.

15. While the taxpayer failed to comply with the normal business method and practice of pooling monies to be

expended centrally and to be collected centrally so that the general excise taxes were paid centrally, the failure to accomplish this method does not necessarily defeat the concept of joint operation or joint venture. Although it would have been appropriate for OWLP and HHOC to file a single general excise tax return for the Outrigger West Hotel as a joint venture or partnership, they did not do so. The fact that they filed separate returns did not prejudice the collection of taxes by the State of Hawaii.

16. Although the form selected by the OWLP and HHOC did not precisely fit into the mold of partnership or joint venture, the substance of their business transactions was that of joint venture. Neither OWLP nor HHOC obtained any tax benefits by virtue of the form of their written agreement or by the separate reporting for general excise and net income tax purposes.

17. OWLP correctly reported its general excise taxes for the years 1974-77 on the returns filed for those years. It did not owe any additional general excise taxes for those years, and the assessment of additional taxes was therefore erroneous.

CONCLUSIONS OF LAW

18. No formal written document is necessary to create a partnership or joint venture. The existence of a partnership or joint venture may be shown by the conduct of the partners. Buffandeau v. Shinn, 60 Hawaii 280 (1978); Ah Leong v. Ah Leong (1977).

19. A partnership is an association (including a joint venture) of two or more persons to carry on as co-owners

of a business for profit. HRS, §425-106. A joint venture is an informal partnership between two or more persons for a limited undertaking or purpose. The rules governing the creation and existence of partnerships are generally applicable to joint ventures. Shinn v. Yee Ltd., 57 Hawaii 215 (1976); Lau v. Valu-Bilt Homes, 59 Hawaii 283 (1978).

20. A joint venture requires only that the parties combine their property, funds, efforts and skills in a common undertaking. It is not necessary that the contribution of each be of the same character. Co-ownership of each item of capital or property is not necessary, so long as each joint venturer contributes something promotive of the enterprise. Wood v. Western Beef Factory, Inc., 378 F.2d 98 (10th Cir., 1967).

21. Even where the documentation for a joint venture does not explicitly state that there will be a sharing of profits, where the operations over several years demonstrate the intent to share profits, the profit-sharing element of joint venture is established.

22. In determining tax liability, substance, rather than the form of the transaction, governs. In re Taxes, Kobayashi, 44 Hawaii 584 (1961). Both the government and the taxpayers may rely on the principle of substance over form. In re Taxes, Ulupalakua Ranch, 52 Hawaii 557.

23. In order for a taxpayer to assert substance over form, the taxpayer must show that tax advantage was not the motivating factor for the form. In re Taxes, Ulupalakua Ranch, supra; In re Hawaiian Telephone Co., 57 Hawaii 477 (1977). The evidence showed that OWLP and HHOC did not

choose the form of their agreement to gain any tax advantage. OWLP may therefore assert the substance for determination of its tax liability.

24. The substance of the operations of the Outrigger West Hotel by OWLP and HHOC was a joint venture.

25. The parties' failure to file a partnership registration until 1979 does not preclude the previous existence of a partnership or joint venture. Partnership existence is not contingent upon filing a partnership registration.

26. The fact that OWLP and HHOC filed separate general excise tax returns instead of one partnership return does not estop OWLP from having its taxes properly determined in the event of assessment and litigation. Tax Appeal of Photo Management, Inc., 63 Hawaii 674 (1981); May & Co. v. Assessor, 14 Hawaii 639 (1903). By the two returns, OWLP and HHOC reported and paid taxes on all receipts of their joint venture, the Outrigger West Hotel. The Department of Taxation is not entitled to more.

27. The taxpayer, OWLP, is not liable for the additional general excise taxes assessed for the years 1974 through 1977; and judgment will be entered for the taxpayer and against the Director of Taxation for refund of the total sum of $194,753.75, plus filing fees and interest on such from December 18, 1980, as provided by law.

DATED: Honolulu, Hawaii, February 9, 1982.

Robert Won Bae Chang
ROBERT WON BAE CHANG
Presiding Judge

APPROVED AS TO FORM:

T. BRUCE HONDA

T. BRUCE HONDA
Deputy Attorney General