

January 19, 1927.

OPINION No. 1412.

TAXATION; INCOME; MAINLAND
MUNICIPAL BONDS:

The Territory may constitutionally impose an income tax upon such mainland municipal and city bonds only as were issued for purposes partaking of the nature of public utilities.

Honorable Henry C. Hapai,
Treasurer, Territory of Hawaii,
Honolulu, Hawaii.

Sir:

Sometime ago the opinion of this department was requested as to whether or not the income derived from mainland municipal and city bonds owned in Hawaii might constitutionally be taxed under our income tax statutes. The question arose directly out of an appeal taken by Ewa Plantation Company from an assessment of such income in the year 1925. Somewhat later it was agreed that the Ewa case should go to a judicial decision, and it was stipulated by several other taxpayers that they should abide by the result of the case.

Since that time I have made a somewhat exhaustive study of the law bearing upon this subject, and have come to the conclusion that the Territory may tax the income from such mainland municipal and city bonds only as were issued for purposes partaking of the nature of what we ordinarily term public utilities.

The case of *Farmers & Mechanics Savings Bank of Minneapolis vs. State of Minnesota*, 58 L. Ed., 706, a United States Supreme Court decision, is controlling to the effect that the Territory, being a mere instrumentality of the Federal Government,—a political subdi-

vision thereof, and not a sovereignty—may not tax the income received from the ordinary mainland municipal bond. It is true that in the Minnesota case the question involved the right of a state to tax the income from bonds issued by a municipality of the Territory of Oklahoma, but the principle is the same, whether involving the right of the state to tax the municipal bonds of a Territory or the right of a Territory to tax the municipal bonds of a sister state.

No logical distinction is perceived between the case of the ordinary municipal bond and that of a highway improvement or school district bond, inasmuch as the true test seems to be, not whether the municipality's general credit and taxing power is behind the issue, but whether or not the function for which the bonds are issued is a sovereign function, rather than a corporate function.

First National Bank vs. Kentucky, 19 L. Ed., 701;

Union Pacific Railway Co. vs. Peniston, 21 L. Ed. 787, 793;

Flint vs. Stone Tracy Co., 55 L. Ed. 389.

It is well recognized, however, that a municipality acts in a dual capacity, namely, that of a public or governmental and sovereign nature, and that of a private or corporate nature.

19 Ruling Case Law, 697, 717, 1130, 1132.

It is also recognized that a municipality acts in its private or corporate capacity in establishing and maintaining a street railway system, an electric light and power plant, a gas plant, a water system, an irrigation project, and other enterprises of a similar nature. It is the opinion of this department that the income from

municipal bonds issued for any of these purposes is not exempt from taxation by the Territory. The principle upon which this is based is, of course, that the Territory, by such taxation, does not interfere with the exercise, upon the part of the state or its municipalities, of a strictly sovereign function, but rather, on the other hand, of a corporate function. That such exemption would also be unfair in a practical way is apparent from the fact that it would favor municipal enterprise when it entered the field of usual and legitimate private enterprise in the same lines.

Flint vs. Stone Tracy Co., supra.

South Carolina vs. United States, 50 L. Ed. 261.

It is the opinion of this office, therefore, that the Territory may constitutionally tax the income from such mainland municipal and city bonds only as were issued for purposes partaking of the nature of the ordinary public utilities.

If this conclusion is concurred in, kindly so advise this department and all of the tax matters pending and involving this point can be quickly disposed of in the Tax Appeal Court.

Respectfully,

H. R. HEWITT,
Second Deputy Attorney General.

APPROVED:

MARGUERITE K. ASHFORD,
Acting Attorney General.