
January 10, 1939,

OPINION NO. 1684

TAXATION; GROSS INCOME; SUGAR ACT BENEFITS, NATURE OF,

Payments received under tire Sugar Act of 1937 are derived from the business or privilege of growing sugarcane.

SAME; NATURE OF TAX.

A grower of sugarcane who also is engaged in milling or processing pays the tax measured by the value of the sugar milled for the privilege of engaging in milling or processing; the tax so measured is not imposed upon the business or privilege of growing sugarcane.

SAME; SAME.

A grower of sugarcane who also is engaged in selling sugarcane in its natural state pays the tax measured by the gross proceeds of sale for the privilege of engaging in selling such products; the tax so measured is not imposed upon the business or privilege of growing sugarcane.

SAME; RATE OF TAX.

The payments under the Sugar Act of 1937 having been derived from the exercise of a privilege not taxable under other subsections of section 2 of Act 141, L. 1935, i.e., from the exercise of the privilege of growing sugarcane, such payments must be returned for taxation at the l¼ per cent rate, as provided by section 2-I H of said Act. 141.

SAME; SUGAR ACT PAYMENTS, APPLICABLE TO.

Provisions of Act 141, L. 1935 disclose the intention of the Legislature that payments such as payments under the Sugar Act of 1937 should be taxed under that Act.

SAME; SAME.

The payments under the Sugar Act of 1937 are part of the gross income of the taxpayers to whom such payments are made.

CONSTITUTIONAL LAW; TAXATION OF SUGAR ACT BENEFITS.

The source of the payments under the Sugar Act of 1937 is within the Territory to the extent required for due process of law; and taxation thereof does not impose an unconstitutional burden on interstate commerce.

TAXATION, GROSS INCOME; DEDUCTIONS ALLOWABLE.

Though the taxpayer pays additional wages in order to comply with the conditions imposed by section 301 of the Sugar Act of 1937, such additional wages cannot be deducted from the payments received for purposes of the tax imposed by Act 141, L. 1935.

Honorable Wm. Borthwick
Tax Commissioner,
Territory of Hawaii,
Honolulu, T. H.

Sir:

You have requested our opinion as to whether or not the payments received by local planters under the Sugar Act of 1937 are liable to the tax imposed by Act 141, L. 1935, and have transmitted to us a memorandum prepared by counsel for one of the taxpayers. You also inquire whether it makes any difference that the taxpayers, for the purpose of complying with the conditions imposed by section 301 of the Sugar Act of 1937, aid wages which were in excess of the wages which otherwise would have been paid. Disposition of this matter requires consideration of several points as follows:

1. Nature of the payments by the Federal Government.

The Sugar Act of 1937, 50 Stat. 903, c. 898, provides in sec. 301:

"The Secretary is authorized to make payments on the following conditions *with respect to sugar or liquid sugar commercially recoverable from the sugar beets or sugarcane grown on a farm* for the extraction of sugar or liquid sugar: * * *"

Sec. 302 (a) provides:

"The amount of sugar or liquid sugar with respect to which payment may be made shall be the amount of sugar or liquid sugar commercially recoverable, as determined by the Secretary, from the sugar beets or sugarcane grown on the farm and marketed (or processed by the producer) not in excess of the proportionate share for the farm * * *."

Sec. 303 provides:

"In addition to the amount of sugar or liquid sugar with respect to which payments are authorized under subsection (a) of section 302, the Secretary is also authorized to make payments, on the conditions provided in section 301, with respect to bona-fide abandonment of planted acreage and crop deficiencies of harvested acreage, resulting from drought, flood, storm, freeze, disease, or insects * * *."

Further provisions of sec. 303 are to the effect that only one-third of the normal yield shall enter into the computation of payments in the case of abandonment of acreage and only 80 per cent of the normal yield with respect to crop deficiencies due to disease, insects, etc.

Sec. 304 (b) provides that in the calculation of payments the Secretary shall determine what constitutes a farming unit, taking into consideration the use of common work stock, equipment, labor, management and other pertinent factors. The payment is to be determined with respect to the farming unit, the Act

providing a sliding scale which reduces the rate of payment as the amount of sugar increases.

From the foregoing provisions it appears that the payments under the Sugar Act of 1937 are derived from the growing of sugarcane on a farming unit. This is clear, since such payments may be received whether the sugarcane is marketed, processed, abandoned, or lost through disease, insects, etc. Although the amount of the payment differs, more sugar coming into the measure of payment if marketed or processed than if abandoned or lost, it nevertheless is true that the source of the payment is the growing of sugarcane. The marketing, processing, abandonment or loss are merely incidental to the measure of the payment; the source of the payment is the business of growing sugarcane.

The conditions provided in section 301 of the Act, with which the producer must comply in order to receive payment, are consistent with the foregoing. Three of the five conditions imposed by said section 301 relate to labor and farm practices in connection with the growing of sugarcane. The other two conditions relate to the quota for the farming unit, and to the relations between a grower who is also a processor and other growers.

It must be concluded that the payments under the Sugar Act of 1937 are derived on account of the business or privilege of growing sugarcane.

2. *Imposition of tax by Act 141 (Series A-44), L. 1935.*

Section 2-1 provides:

"There is hereby levied and shall be assessed and collected annually privilege taxes against the persons on account of their business and other activities in this Territory, measured by the application of rates against values, grow proceeds of sale or gross income, as the case may be, as follows: * * *"

Under this sec. 2-l there appear several subsections, among them the following:

"A. Tax on manufacturers. (1) Upon every person engaging or continuing within this Territory in the business of manufacturing, * * * milling, processing, * * * either directly or through the activity of others, in whole or in part, * * * the amount of such tax to be equal to the value of the articles, substances or commodities, manufacturer, * * * as shown by the grow procceds derived from the sale thereof * * *".

"B. Tax on retailers, wholesalers and producers. (1) Upon every person engaging or continuing within this Territory in the business of selling any tangible personal property whatsoever * * * there is likewise hereby levied, and shall be assessed and collected, a tax equivalent to one and one-quarter (1¼) per cent of the gross proceeds of sales of the business; provided, however, that in the case of a wholesaler or producer, the tax shall be equal to one-quarter (¼) of one per cent of the grow proceeds of sales of the business."

A producer is defined by section I (11) as follows:

"The term 'producer' shall mean and include any person engaged in the business of raising and producing agricultural products * * * who sells agricultural *** * *** products in their natural state * * * for resale or to be incorporated and remain in finished manufactured products * * *."

It is clear that the tax upon a grower of sugarcane who also is engaged in milling or processing is imposed upon the business of milling or processing, and not upon the business of growing sugarcane. A processor who grows the agricultural product processed by him pays the tax imposed by section 2-I A, measured by the value of the commodities manufactured or processed, solely for the privilege of manufacturing or processing, and such tax is not imposed upon the privilege of raising agricultural products.

Likewise the tax upon a grower of sugarcane who also is engaged in selling his products is imposed upon the business of selling, and not upon the business of growing sugarcane. Although "producer" is defined by said Act 141, L. 1935 so as to include the business

of producing agricultural products, the tax imposed by section 2-1 B is on the privilege of selling such products. There are some exceptions to the foregoing which do not affect the present matter. (See sections 2-I B [5] and 2-II of said Act 141.) These exceptions were intended to take care of situations where a tax on the privilege of selling would not serve the Legislature's purpose, and they emphasize the fact that the Legislature deliberately intended the tax to fall on the privilege of selling in the usual case. A grower of sugarcane who sells his products pays the tax imposed by section 2-1 B, measured by the gross proceeds of sale, for the privilege of selling, and such tax is not imposed upon the privilege of growing sugarcane.

In this situation section 2-I H of said Act 141, L. 1935 applies. Section 2-I H is as follows:

"Tax on other business. Upon every person engaging or continuing within this Territory in any business, trade, activity, occupation, or calling not included in the preceding subsections or any other provisions of this Act, there is likewise hereby levied and shall be assessed and collected, a tax equal to one and one-quarter (1¼) per cent of the gross income thereof. This subsection shall apply to the gross income of persons taxable under other subsections hereof not derived from the exercise of privileges taxable thereunder."

The payments under the Sugar Act of 1937 having been derived from the exercise of a privilege not taxable under other subsections of section 2 of Act 141, L. 1935, i.e., from the exercise of the privilege of growing sugarcane, such payments must be returned for taxation at the 1¼ per cent rate, as provided by section 2-I H of said Act 141 above quoted.

3. *The Legislature intended that payments such as payments under the Sugar Act of 1937 should be taxed.*

There are indications in said Act 141, L. 1935 that the Legislature contemplated the taxation of benefit payments received from the Federal Government under such plans as that embodied in the Sugar Act of 1937. In sec. 2-I A (6) it is provided that a processing tax or similar tax paid by reason of the Agricultural Adjustment Act or other Federal acts may be deducted from gross income, with this proviso:

> "* * * provided, however, that this paragraph shall not be construed to entitle the taxpayer to deduct any sums that may be returned and retained as a benefit payment so-called or a like payment by virtue of the Agricultural Adjustment Act or other Acts passed by the Congress of the United States relating thereto."

The intention of the Legislature is disclosed even more clearly by sec. 4 (2) which provides that the provisions of this Act shall not apply to:

> "(r) The amount received by any person as a benefit payment so-called or like payments by virtue of the Agricultural Adjustment Act or other Acts passed by the Congress of the United States relating thereto and disbursed to others as such benefit payment: provided that the commissioner may by rule require any deductions to be set forth specifically by the taxpayer in his return * * * ."

Thus the Legislature contemplated that benefit payments under the Agricultural Adjustment Act and similar acts should be included in gross income and deducted only to the extent that such payments were disbursed to others "as such benefit payment".

4. The question whether or not the payments are "gross income".

The memorandum of counsel for one of the taxpayers denies that the payments can be considered gross income in any event.

Act 141, L. 1935 defines gross income as follows:

> "Gross income means * * * the gross receipts of the taxpayer derived from trade, business, commerce or sales* * * ." Sec. 1 (6).

Counsel for the taxpayer cites *Edwards v. Cuba R. R. Co.*, 268 U. S. 628, 69 L. Ed. 1124, and other cases following the doctrine of that case. The *Edwards* case, involving net income tax, was founded on three premises: (1) That the payments were made to reimburse the taxpayer for capital expenditures and hence were a contribution to capital assets. (2) (Further supporting the first point.) Such payments were not to be used to pay dividends, interest, or anything else properly chargeable to earnings or income. (3) Such payments were not gains from the operation of the railroad. See the *Edwards* case and see the analysis of that case in 1 Paul & Mertens Federal Income Taxation, 159, sec. 6.12. There are other lines of cases which hold payments by the government taxable. One such case is *Oahu Railway and Land Co.* v. *Pratt*, 14 Haw. 126, involving payments of $700,00 each year for each mile of track constructed for the period of five years from the date of construction, under Civil Laws 1897, sec. 581. The case, however, does not contain any discussions as to whether or not such payments are income. Other cases which do discuss the point and distinguish the *Edwards* case point out that the *Edwards* case was based on the proposition that the payments there involved were contributions to capital. Among these are the following:

Helvering v. *Claiborne-Annapolis Ferry Co.*, 93 F. (2d) 875 (C. C. A. 4, 1938). In this case the taxpayer received from the state of Maryland for the maintenance of its ferry the sum of $23,000.00, or $1,000.00 per mile of distance across the bay, which was paid in monthly installments. It was held that these payments must be included in gross income for the purpose of computing net income. The court said:

"And it is equally clear that the amount paid by the state was not intended by anyone as a contribution towards or an addition to the capital investment of the taxpayer. Taxpayer's capital was invested in wharves and ferry-boats; and the payment by the state was intended, not to reimburse taxpayer for expenditures it had made in their purchase or equipment, but to compensate it in part for their operation. As stated above, it was treated in all respects like other income and was available for operating expenses or for the payment of dividends. The case of Edwards v. Cuba Railroad Co., 268 U. S. 628, 45 S. Ct. 614, 615, 69 L. Ed. 1124, upon which taxpayer chiefly relies, is readily distinguishable. In that case the subsidy payments made by the Cuban government were used to reimburse taxpayer for capital expenditures. * * *

"* * * The subsidy paid taxpayer by the state of Maryland was more nearly analogous to the case of 'additional compensation' awarded the railroads by the government during the period of federal control, which has been held properly taxable as income of the railroads. * * *"

In *Texas and Pacific Ry. Co.* v. *United States, 286* U. S. 285, it was held that an allowance received by the taxpayer pursuant to the Transportation Act of 1920 which provided for the guarantee of operating income during the six months' period after relinquishment of Federal control, was taxable income. The court said:

" * * * The purpose of the guaranty provision was to stabilize the credit position of the roads by assuring them a minimum operating income. They were bound to operate their properties in order to avail themselves of the Government's proffer. Under the terms of the statute no sum could be received save as a result of operation. * * *

"The sums received under the act were not subsidies or gifts,—that is, contributions to the capital of the railroads,—and this fact distinguishes cases such as Edwards v. Cuba Railroad Co., 268 U. S. 628, where the payments were conditioned upon construction work performed. * * *"

The payments under the Sugar Act of 1937 are made as the result of operation of the business by the taxpayer. Such payments are made on account of the sugar commercially recoverable from sugarcane grown in the operation of the business; and are made to induce compliance with certain conditions as to operations, both as to farming practices and payment of

labor, and also as to quantity produced. The payments can be used to reimburse expenses and unlike the payments in the *Edwards* case are not the reimbursement of capital expenditures. It is clear that such payments are within "gross income" as defined by Act 141, L. 1935.

5. *The source of the payments is within the Territory and interstate commerce is not affected.*

Taxpayer's counsel refers to the interstate commerce clause and submits that the source of the payments is outside of the Territory. Conceding that due process of law requires a source of taxation which is within the jurisdiction of the Territory, such jurisdiction is unquestionable. As previously submitted the source of the payments is the growing of sugarcane within the Territory. Nor does the tax impose an unconstitutional burden on interstate commerce. In the case of *J. D. Adams Mfg. Co.* v. *Storen,* 304 U. S. 307, 82 L. Ed. 1365, cited by taxpayer's counsel, it is recognized that a tax may be imposed on account of intrastate activity although the taxpayer is engaged in interstate commerce, but in that case the tax was not an excise upon the privilege of producing within the state. It was a tax of such character "that if lawful it may in substance be laid to-the fullest extent by states in which the goods are sold as well as those in which they are manufactured." The principle is more fully explained in *Western Live Stock* v. *Bureau of Revenue,* 303 U. S. 250, 82 L. Ed. 823, in which the court, speaking of taxes measured by gross receipts as affected by interstate commerce conducted by the taxpayer, says:

"The vice characteristic of those which have been held invalid is that they have placed on the commerce burdens of such a nature as to be capable, in point of substance, of being imposed * * * or added to * * * with equal right by every state which the commerce touches, merely because interstate commerce is being done, so that without the protection of the commerce clause it would bear cumulative burdens not imposed on local commerce. * * * The multiplication of state taxes measured by the gross receipts from interstate transactions would spell the destruction of interstate commerce and renew the barriers to interstate trade which it was the object of the commerce clause to remove. "

In the present situation there is no danger of "multiplication of state taxes".

6. *There can be no deduction for additional wages paid in compliance with the conditions imposed by sec.* 301.

Although the taxpayers in order to qualify for payments paid wages in excess of the wages which otherwise would have been paid, such additional wages can not be deducted any more than other costs or expenses, The only provision of Act 141, L. 1935, which could have any bearing would be sec. 4 (2) (r) above quoted. This section only provides for the deduction of an amount received as a benefit payment and "disbursed to others as such benefit payment". The disbursements here involved were required by the Sugar Act of 1937 to be made as wages, and were so made; also these disbursements were not made out of the payments received.

Respectfully,

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Deputy Attorney General.

APPROVED:

J. V. HODGSON,
Attorney General.