



TERRITORY OF HAWAII
DEPARTMENT OF THE ATTORNEY GENERAL
HONOLULU

45, 5

October 29, 1940

OPINION NO. 1748

TAXATION; PUBLIC UTILITIES TAX;
NON-OPERATING INCOME:

The public utilities tax applies to gross non-operating income as well as to the gross operating income from the public utility business.

SAME; SAME; SAME:

Where a company has both a utility and a non-utility business the income from investments derived from public utility funds is subject to the public utilities tax.

SAME; SAME; EXEMPT INCOME:

Constitutional immunity from taxation, such as in the case of federal bonds, applies to the public utilities tax, as does immunity conferred by territorial law upon the issuance of territorial or county bonds, but exemptions, such as the exemption of dividends contained in the income tax law, do not apply.

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

Dear Sir:

Your letter of January 17 requests our advice as to

the inclusion of dividends, interest and other non-operating income of a public utility in "gross income" for the computation of the tax imposed by Act 43, 2d Sp. S. L. 1932, now Chapter 69, R. L. 1935.

Said Act 43, 2nd Sp. S. L. 1932, as amended by Act 183, L. 1933, provides:

"Sec. 1. Public utility tax. In lieu of all taxes other than income taxes, the specific taxes imposed by Chapter 102 of the Revised Laws of Hawaii 1925, as amended, and the fees prescribed by Chapter 132 of said Revised Laws, as amended, and any tax specifically imposed by the terms of its franchise, there shall be levied and assessed upon each public utility within the Territory a tax of such rate per cent of its gross income each year from its public utility business as shall be determined in the manner hereinafter provided."

"Section 2. Definitions. (a) The term 'public utility' as used in this Act shall have the meaning given that term in section 2208, as amended, of the Revised Laws of Hawaii 1925. (b) the term 'gross income' shall have the meaning of that term as used in section 2207 of said Revised Laws. (c) the term 'net operating income' means the operating revenues less the operating expenses and tax accruals, including in the computation of such revenues and expenses, debits and credits arising from equipment rents and joint facility rents.

"Section 3. Returns. Each public utility on or before March 20 in each year shall file with the tax collector for the division within which the principal office of the public utility is maintained, a return in such form as the tax commissioner may prescribe, showing its taxable gross receipts for the preceding calendar year. In case any public utility carries on other lines of business than its public utility business, the receipts therefrom shall not be subject to tax under this Act, but the same tax liabilities shall attach to such public utility on account of such other lines of business and the real property

used in connection therewith as would exist if no public utility business were done.

"Section 4. Rate how determined. The rate of the tax upon the gross income of any public utility for the purposes of this Act shall be determined as follows: If the ratio of the net income of the company to its gross income is fifteen per cent (15%) or less, the rate of the tax on gross income shall be five per cent (5%); for all companies having net income in excess of fifteen per cent (15%) of the gross, the rate of the tax on gross income shall increase continuously in proportion to the increase in ratio of net income to gross, at such rate that for each increase of one per cent (1%) in the ratio of net income to gross, there shall be an increase of one-fourth of one per cent ($\frac{1}{4}\%$) in the rate of the tax. The following formula may be used to determine such rate, in which formula the term 'r' is the ratio of net income to gross income, and 'x' is the required rate of the tax on gross earnings for the utility in question:

$$x = (1.25 + 25r)\%$$

provided, however, that in no case shall 'x' be less than five per cent (5%)."

In Hawaii Consolidated Ry. v. Borthwick, 34 Haw. 269, 278, aff'd 105 Fed.(2d) 286, our Supreme Court (the Circuit Court of Appeals not passing upon this point) had this to say:

"In the ordinary commercial enterprise gross income is classified accordingly as it is derived from the operating or nonoperating departments of the business and is ordinarily referred to as gross operating and gross nonoperating income, an instance of the latter of which is income from the investments of surplus and otherwise. This classification is equally applicable to gross income from utility business as instanced in the case of a railroad's gross operating income from its railroad and gross nonoperating income from investments of its surplus from utility business. The statute, in using the words 'gross income from its utility business,' clearly

contemplates gross income from both its operating utility business and its nonoperating utility business. * * * "

As indicated by the above and by the approval by this office, on October 29, 1937 (L.F. 45, No. 944) of the form of certain instructions to taxpayers covering this matter, the expression "its gross income each year from its public utility business" includes both gross operating and gross non-operating revenues of the utility business.

The argument made against this interpretation assumes that the Public Utility Tax Act of 1932 (Act 43, 2d Sp. S. L. 1932) established solely a changed method of taxing the same properties which previously had been taxed by the "enterprise for profit" method. Undoubtedly the elimination of the enterprise for profit method of valuing property without entirely eliminating from consideration revenue producing potentialities of the property of a public utility, was one of the primary concerns of the Legislature. However, at the same session the Legislature made other sweeping changes. It eliminated the personal property tax (though restoring the same in 1933), and it shifted to the general revenues of the Territory the burden of meeting some needs which prior to the 1932 session had been met out of the property tax rate. Compare Section 1315, R. L. 1925, as amended, the last amended form being Act 183, L. 1931, with Section 21, Act 40, 2d Sp. S. L. 1932. It also provided

new sources of territorial revenue in the Business Excise Tax Act, Act 42, 2d Sp. S.L. 1932, as well as revising existing taxes. These tax acts were all enacted as part of one comprehensive scheme of taxation, the Second Special Session having been called for that purpose. Senate Journal, 2d Sp. Sess. 1932, p. 2; Bishop v. Hill, L. 14488, Circuit Court, First Circuit, decision of Sept. 21, 1934 (affirmed 33 Haw. 371). There is no reason to suppose that the Legislature, in looking to the new sources of revenue and in deleting from the property tax rate certain items previously met from that source, intended that public utilities should be favored over other corporations and businesses in the matter of taxable sources.

The Business Excise Tax, from which public utilities were exempted by Section 1 of said Act 43, 2d Sp. S. L. 1932 "in so far as their public utility business is concerned", applied to non-operating, as well as operating revenues of a business. Continuing the same policy the Legislature, in enacting the Gross Income Tax Law in 1935 (Act 141 (Ser. A-44) L. 1935), included non-operating revenue in the measure of the tax (Section 1 (6)), but exempted: 'Public Utilities (as that term is defined in the Revised Laws of Hawaii 1935, Section 7940) with respect to their public utilities business) upon the gross income from which they pay an annual tax under the provisions of the Revised Laws of Hawaii 1935, chapter 69."

(Sec. 4 (1) (c)). The non-operating revenue of a public utility either was regarded by the Legislature as a part of the public utilities business, and hence subject to tax under the public utilities tax act, or as not a part of the public utilities business and hence subject to business excise tax and later to gross income tax. The question is, which?

Further expression of the legislative intent is to be found in Section 3 of the Public Utilities Tax Act (Act 43, 2d Sp. S. L. 1932) which provides:

"In case any public utility carries on other business than its public utility business, the receipts therefrom shall not be subject to tax under this Act, but the same tax liabilities shall attach to such public utility on account of such other lines of business and the real property used in connection therewith as would exist if no public utility business were being done."

Therefore the expressions "gross income each year from its public utility business" in Section 1, of Act 43, 2s Sp. S. L. 1932, "in so far as their public utility business is concerned in Section 2 of Act 42, 2d Sp. S. L. 1932, and "with respect to their public utilities business, upon the gross income from which they pay an annual tax under the provisions of the Revised Laws of Hawaii 1935, chapter 69" in Section 4 (1) (c) of Act 141 (Ser. A-44) L. 1935 are to be determined as including or not including non-operating income of the public utility

from its investments according to whether or not such investments constitute a distinct line of business.

The Public Utilities Tax Act refers to the definitions of "public utility" and "gross income" contained in Sections 7940 and 7965, R. L. 1935 (formerly Sections 2207 and 2208, R. L. 1925). These sections are part of the chapter covering the authority of the Public Utilities Commission over public utilities, now Chapter 261, R. L. 1935. It therefore is pertinent to inquire as to what the Legislature conceived to be part of the public utility business from the standpoint of investigation and supervision by the Public Utilities Commission, as it must have had the same conception of public utilities business in imposing the fee or tax required by Section 7965, R. L. 1935 and the tax levied by said Act 43, 2nd Sp. S. L. 1932, Chapter 69, R. L. 1935.

That the investments made by the public utility were conceived by the Legislature to be part of its public utility business, and not a distinct line of business, is clearly shown by the statute, which provides:

"Sec. 7945. May investigate what. The Commission and each commissioner shall have power to examine into the condition of each public utility doing business in the Territory, * * * the issuance by it of stocks and bonds, and the disposition of the proceeds thereof, the amount and disposition of its income, and all its financial transactions * * *"

"Sec. 7956. Acquisition of stock of another public utility. No public utility corporation shall purchase or acquire, take or hold, any part of the capital stock of any other public utility corporation, organized or existing under or by virtue of the laws of the Territory, without having been first authorized to do so by the order of the commission. * * *"

"Sec. 7955. Issuance of securities. A public utility corporation may, on securing the prior approval of the commission, and not otherwise, issue stocks and stock certificates, bonds, notes and other evidences of indebtedness, payable at periods of more than twelve months after the date thereof, for the following purposes and no other, namely: For the acquisition of property or for the construction, completion, extension or improvement of or addition to its facilities or service, or for the discharge or lawful refunding of its obligations or for the reimbursement of moneys actually expended from income or from any other moneys in its treasury not secured by or obtained from the issue of its stocks or stock certificates, or bonds, notes, or other evidences of indebtedness, for any of the aforesaid purposes except maintenance of service, replacements and substitutions not constituting capital expenditure in cases where the corporation shall have kept its accounts for such expenditures in such manner as to enable the commission to ascertain the amount of moneys so expended and the purposes for which such expenditures were made, and the sources of the funds in its treasury applied to such expenditures. "

Under these provisions a company could not contend that the amount devoted by it to investments as distinguished from plant and the like, and its financial transactions in connection with such investments, were of no concern to the Public Utilities Commission. All investments derived from public utility funds should be deemed part of the public utility business.

Where a company has a distinct non-utility department, and accordingly it is necessary to distinguish between

utility and non utility funds, of course all capital obtained for utility purposes, and all insurance funds and other funds or reserves built up out of charges to revenue of the utility business, or held for the purposes of the utility business, should be attributed to the utility business. In addition, surplus derived from utility revenues should be attributed to the utility business. Income from investments, to the extent that the investments represent such capital, funds, reserves or surplus, should be included in gross income from the utility business.

You also have inquired as to whether it makes any difference if the income is non-taxable under the Federal and Territorial Income Tax Laws. Income from investments conceivably might be non-taxable for income tax purposes for any one of three reasons i.e. (1) constitutional immunity from taxation, such as in the case of federal bonds; (2) immunity of territorial or county bonds conferred by the territorial law governing their issuance; (3) specific exemption in the income tax law.

The first type of immunity applies to the public utilities tax, unless that tax is a franchise tax. Education Fiims Coloration v. Ward, 282 U.S. 379; 57 A.L.R. 899, 902; 71 A.L.R. 256, 269. I am satisfied that the public utilities tax was not framed as a franchise tax, and it has not previously

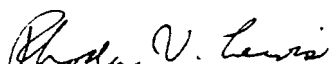
been construed by this department as a franchise tax when questions of tax exempt property were involved. Ops. Atty. Gen. (1935) No. 1615, citing Senate Journal, 2d Sp. Sess. 1932, p. 34.

With respect to the second type of immunity, this also applies to the public utilities tax on the theory that it is not a franchise tax. Compare Pacific Co. v. Johnson, 285 U.S. 480. Our statutes exempting the bonds from taxation have always been regarded as exempting the interest also. See Oahu Railway and Land Co. v. Pratt, 14 Haw. 126.

The third type of exemption has no application outside the income tax law itself. Although the income tax law specifically excludes certain dividends from "gross income", the Public Utilities Tax Act does not refer to the income tax law for the definition of gross income. Consequently dividends are to be included. The argument that this may result in a pyramiding of the tax is one which only the Legislature may consider. The tax on gross income of shares of a public utility held by another public utility is no more invalid than a tax upon the shares of stock of a corporation coupled with a tax upon the property of the corporation.

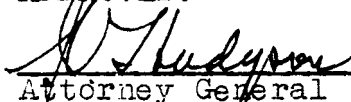
Arguments made upon behalf of a certain utility, based upon past administrative practice, do not influence the result because the statute is not ambiguous. Ewa Plantation v. Wilder, 26 Haw. 299, 316, aff'd 289 Fed. 664.

Respectfully,



Rhoda V. Lewis
Deputy Attorney General

APPROVED:



Attorney General