L. NO. 23029

IN THE CIRCUIT COURT OF THE FIRST JUDICIAL CIRCUIT

TERRITORY OF HAWAII

PAUL J. BRUHN, Collector of Delinquent Taxes of the Territory of Hawaii,
Plaintiff,

vs.

ANTONE P. MORANHA,
Defendant.

1st Circuit Court
Territory of Hawaii
FILED
1957 May 13 PM 2:29
/s/ [illegible]
Clerk

OPINION LETTER NO. 57-39

MEMORANDUM ON BEHALF OF PLAINTIFF

W. K. WATKINS, JR.
Deputy Attorney General
Territory of Hawaii

Attorney for the Plaintiff

Office of the Attorney General
Iolani Palace Grounds
Honolulu, T. H.

L. NO. 23029

IN THE CIRCUIT COURT OF THE FIRST JUDICIAL CIRCUIT
TERRITORY OF HAWAII

PAUL J. BRUHN, Collector of Delinquent Taxes of the Territory of Hawaii

Plaintiff,

vs.

ANTONE P. MORANHA,

Defendant.

MEMORANDUM ON BEHALF OF PLAINTIFF

During Plaintiff's oral argument contesting the motion to dismiss the court terminated the discussion by requesting both counsels to submit a memorandum on two questions before the court, which are set forth below in parts I and II.

I

Query: Was aforesaid section 5469 such a violation of the due process clause that all assessments made pursuant to it must be deemed invalid?

Every enactment of the legislature carries a presumption of constitutional validity and should be upheld by the courts unless it has been shown to be, beyond all reasonable doubt, in violation of the Constitution. Bishop v. Mahiko, 35 Haw. 608, 641. The court, it is true, is justified in adopting a construction that will sustain the validity of a statute only where its language will bear two constructions. It is equally true, however, that the legislature should be assumed to have had all applicable facts and laws, both Territorial and Federal, in mind when it first enacted and later amended the statute that subsequently became said section 5469.

One of those facts was that our Supreme Court in Wilder v. Colburn, 21 Haw. 701, appeal dismissed 242 U.S. 657, 61 L. Ed. 548, had clearly considered the constitutionality of section 1235, Revised Laws of Hawaii 1905 which stated:

> "If any person shall refuse or neglect to make said return....the assessor may make such assessment according to the best information within his reach, and the same shall be binding and conclusive upon all parties and shall not be subject to appeal."

Counsel for the plaintiff-in-error, relying mainly on Central of Georgia Railway v. Wright, 207 U.S. 127, 52 L. Ed. 134, argued that lack of constitutionality destroyed that entire statute because of failure to provide due process but the court, commencing on page 708, clearly distinguished that case, one of the grounds being that there was no suggestion that the plaintiff-in-error had any good reason for not making the returns, and held section 1235 to be constitutional when applied to obdurate or negligent persons.

Consequently, it should be assumed that when the legislature twenty-two years later first enacted the statute that subsequently became said section 5469 and spoke of persons who "fail or refuse to make a return" it had in mind the problem of taxpayers who are obdurate or negligent. So also when the legislature amended that statute in 1941 to apply to "any person (who) shall fail, neglect or refuse to make a return." This assumption is further emphasized by the fact that the annotator of the Revised Laws of Hawaii 1945, cited Wilder v. Colburn, supra, as pertaining to said section 5469 in regard to the finality of such assessment. Thus it would appear that said section 5469, in spite of its apparently clear language, contained a very real ambiguity when the taxes giving rise to this suit were assessed. Therefore, its statement that any assessment made under the statute "shall be final" clearly requires either limitation (A) or modification (B).

A. The matter of limiting said section 5469 can be accomplished by holding that such finality of an assessment made pursuant to it applies only to obdurate or negligent taxpayers under

the rule that where a statute would be unconstitutional as applied to one class of cases and is constitutional as applied to another class, it should be held to have been intended by the legislature to apply only to the latter class. Thus in State v. Williams, 94 Ohio App. 249, 115 N.E. 2d 36, the court in finding constitutional a criminal statute, part of which forbade possessing catfish less than 15 inches in length, held that statute was not intended to apply to a trucker whose load contained, unknowingly, 25 boxes each of whose 100 lb. weight included 10 lbs or more of such forbidden fish. So also in Ferguson v. Commissioner of Corporations and Taxation, 316 Mass. 318, 55 N.E. 2d 618, in which the court upheld the constitutionality of inheritance tax statutes by limiting the scope of the statutes' application so that double taxation was avoided. In point also is Albany County v. Stanley 105 U.S. 305, 26 L. Ed. 1044, where the court slightly limited the scope of a New York tax statute, in so far as it applied to taxing the stock of national banks, in order to hold the statute constitutional. Dissenting Justice Bradley on the contrary believed that state laws authorizing the capital stock of national banks to be taxed without deductions for the stockholders' debts should be declared void in so far as they pertained to national banks.

The solution of limiting the scope of a statute similar to said section 5469 is exactly what the court did in Wilder v. Colburn, supra, when it stated on page 708:

> "The plaintiff-in-error here, therefore, is not in the position of the plaintiff-in-error in Central of Georgia Railway v. Wright. His rights not being affected by what the law may be in case a person fails to make return under circumstances like those appearing in that case it is unnecessary to go into the question whether under such circumstances the procedure prescribed by our statute is lacking in due process of law. A question of the alleged conflict of a statutory provision with the constitution will not be considered at the suit of one whose rights appear not to be affected by such provision."

The controlling decision on the law that a stubborn or negligent taxpayer is not entitled to a hearing as a matter of right is that of Pullman Co. v. Knott, 235 U.S. 23, 26, 59 L. Ed. 105, lll. That case involved a Florida tax on the gross receipts of sleeping

and parlor car companies from business done between points within the state. Pullman Co. believed the tax was unconstitutional and did not file the returns, whereupon the comptroller, as authorized by statute, made the assessment and added 10% as a penalty. In speaking for the Supreme Court, Justince Homes said:

> "The other objection urged is that the taxpayer is not given a hearing. The Statute, as we have said, requires the companies to make a report and fixes a percentage ($1.50 per $100) to be paid. If the report is not made, the comptroller is to estimate the gross receipts and add 10 per cent of the amount of the taxes as a penalty. If the companies do as required there is nothing to be heard about. They fix the amount and the statute established the proportion to be paid over....The provision in case of their failure to report is not, as it seemed to be suggested in argument, an alternative left open for the companies to choose. It is a provision for their failure to do their duty. In that event their chance and right to be heard have gone by."

The provisions of our general excise tax law in force during the period covered by the subject assessment appear clear in their requirement that Defendant file returns on his sales. Section 5455 Revised Laws of Hawaii 1945 stated the tax shall be assessed against persons "on account of their business and other activities in this Territory" and provided in B (2) "that gross proceeds of sales of tangible property in interstate and foreign commerce shall constitute a part of the measure of the tax imposed on retailers and wholesalers, to the extent, under the conditions and in accordance with the provisions of the Constitution". Section 5457 Revised Laws of Hawaii 1945 concerned the apportionment of gross income for persons "engaged in business both within and without the Territory". The necessity for persons engaged in bringing property into the Territory for sale to file returns for their business activities seems clearly stated when section 5458 Revised Laws of Hawaii 1945 is considered in relation to its companion statute providing for erroneous returns and the disallowance of exemptions, section 5467 Revised Laws of Hawaii 1945. Section 5458 stated in part:

> "In computing the amounts, of any tax imposed under this chapter, there shall be excepted from the gross proceeds of sales or gross income, so much thereof as is derived from sales of tangible

> personal property in interstate and foreign commerce, which under the Constitution....the Territory is... prohibited from taxing....”

While section 5467 stated in part:

> “If any return made is erroneous ... or if the taxpayer, in his return, shall disclaim liability for the tax on any gross income or gross proceeds of sales liable to the tax, ... the tax commissioner shall correct such error or assess the proper amount of taxes. If such recomputation results in an additional tax liability ... the commissioner shall first give notice to the taxpayer of the proposed assessment, and the taxpayer shall thereupon have an opportunity within thirty days to confer with the commissioner.”

Plaintiff contends, consequently, that Defendant had the clear duty to make returns on his business activities in the Territory and claim therein, as specifically contemplated by said section 5467, the exemption of the part of his gross proceeds he believed fell within the exclusion of said section 5458. It is obvious that Defendant, in making such returns and contesting the taxability of his activities and stating he owed no taxes on such transactions, would not, thereby, admit himself liable to the tax. Instead, Defendant, after deciding that he was not subject to the tax, did not file his returns.

There is a fundamental distinction between the case at hand and that of Central of Georgia Railway v. Wright, supra. In that case the refusal to file the required returns was caused solely by the fact that while “the officials of the company honestly believe that this stock was not taxable, and that there has never been on their part the slightest effort to conceal” (207 U.S. 136, 52 L. Ed. 141) they were faced with the fact that should they file the returns they would concede the taxability of the property and leave open only the question of the property's valuation, since Georgia law required the taxpayer “to know whether his property is taxable or not” (207 U.S. 137, 52 L. Ed. 141). On the other hand, when the Georgian taxpayer made a wrong decision as to the non-taxability of his property he was faced with the fact that the supreme court of Georgia had decided “the taxing scheme of the state of Georgia, as laid down in its statutes, to be that, while it provides for a method of valuation in case of the return of property for taxation, it does not intend to give to

the taxpayer who fails to return property legally liable to be assessed any opportunity to be heard as to the value of the property or the amount of the assessment (207 U.S. 136, 52 L. Ed. 141).

The alternatives thus left open to the Georgian taxpayer who had doubts regarding the taxability of his property, and who had to choose between the frying pan of conceeding taxability and arguing only as to the amount of the tax or the fire of contesting taxability and forfeiting all right to contest the amount of the tax if he should be wrong, were what caused the court in Central of Georgia Railway v. Wright, 207 U.S. 138, 52 L. Ed. 142, to say in regard to the issue before it:

> "Applying the principles thus settled to the statutory law of Georgia, as construed by its highest court, does the system provide due process of law for the taxpayer in contesting the validity of taxes assessed under its requirements?"

The court again emphasized the reason for its decision when, just prior to making that decision, it said "the system provided in Georgia by the Statutes of the state as construed by its highest court requires of the taxpayer that he return all his property, whether its liability is fairly contestable or not, upon pain of an ex parte valuation, against which there is no relief in the tax proceedings or in the courts...." It was held that to so place the company where it must determine at its peril an arguable point of taxability did not afford it due process of law.

The statutes involved in this case differ from those Georgia statutes on the very material point that no concession of liability was necessarily involved in making a Territorial tax return. Said section 5467 specifically recognized that the return could disclaim liability for the tax. Our statutes therefore did not place Defendant in any peril but merely said that he should file his statement of his case (i.e. file his return) in order that he would be heard upon it. It does not appear how any orderly proceedings could be had otherwise. It is further submitted that the facts of this case will show that there has been a failure on the part of Defendant to exhaust

administrative remedies, allowed him by the general excise tax law, which he could have pursued without the making of any concession on his part.

Moreover, so far as the pleadings and known facts show, the only contention that Defendant desires to present is that the tax is illegal as applied to his business activities. The Hawaii law does not deny him a hearing as to that even though no return was filed. He could have presented that contention in a suit to recover taxes paid under protest, Hilo Sugar Co. v. Tucker, 8 Haw. 148, or he could defend this action upon such grounds, Wilder v. Colburn, supra, page 709, where the court held that neglect or refusal of a taxpayer to make a return does not foreclose him from contesting the legality of the tax in the courts. Hawaii law also permits the question of illegality to be raised in the equity court when there is a suitable case for equitable relief; however, even there Defendant would not be relieved of paying the amount of tax equitably due, i.e., that amount which the court could see is indisputably due. People's National Bank v. Marye, 191 U.S. 272, 48 L. Ed. 180. Due process of law does not guarantee an administrative hearing where no question requiring the exercise of administrative judgment is involved. 84 C.J.S. 819.

The rule that discrimination in taxation between different classes of taxpayers is lawful, when done for proper reasons, was clearly demonstrated in Madden v. Kentucky, 309 U.S. 83, 89, 84 L. Ed. 590, 594. There the court sustained the constitutionality of a tax statute that taxed deposits in banks outside the state at five times the tax rate on deposits in local banks because "by placing the duty of collection on local banks, the tax on local deposits was made almost self-enforcing".

B. The matter of modifying said section 5469 can be accomplished by holding the provision as to the finality of assessments made pursuant to it is not mandatory. The word "shall", though mandatory in its common meaning, may be construed as being permissive or directory in order to effectuate legislative purpose or where the

subject-matter requires. City of Boston v. Quincy Market Cold Storage & W. Co., 312 Masc. 638, 646-647, 45 N.E. 2d 959, 965. The word "shall" must also be construed as permissive when the statute can thereby be upheld, if a construction to the contrary would render it unconstitutional. In City of Denver v. Londoner, 33 Colo. 104, 80 P. 117, 121, one of the grounds of attack on a street paving assessment was the invalidity of the statute creating the board of public works since it mandated the city council to pass such assessments, as determined by the board after reviewing the recommendations of the council. The court in upholding the statute said on page 121:

> "In the case of the Board of Co. Com'rs. v. Smith, 22 Colo. 534, 45 Pac. 357 it was held 'may' be construed as 'shall' when an act of the Legislature can be thereby upheld, if a contrary construction would render it obnoxious to a constitutional inhibition. The converse of this must be likewise true; and hence we conclude that, if the provisions of section 31 are objectionable because apparently mandatory upon the city council, they do not strip the latter of its legislative authority and discretion, but still leave it with the authority to pass an assessing ordinance in accordance with its own judgment."

In Geo. Williams College v. Village of Williams Bay, 242 Wis. 311, 7 N.W. 2d 89, 895, a statute was attacked because it provided that the cost of sewers was to be assessed on the basis of the cost of work rather than on the benefits to the subject property. In holding the statute constitutional the court said on page 895:

> "It is true that the statute before us here is phrased 'shall be assessed,' but very often 'shall' in a statute is construed to mean 'may', especially in order to avoid a constitutional doubt."

Should the court decide that the proper construction of said section 5469 requires "shall be final" to be construed as meaning "may be final", with said finality depending on whether or not the taxpayer so assessed was obdurate or negligent, then clearly Defendant should have pursued his administrative remedies, provided by the general excise tax law, in contesting the applicability of the tax to his business activities and, if he so desired, the amount of the tax as well.

If a statute is open to more than one construction that construction which renders it free from constitutional objection, if

available, must be adopted. Bannister v. Lucas, 21 Haw. 222, 223; Territory v. Miguel, 18 Haw. 402, 409.

The universal rule that courts refuse to pass on the constitutionality of a statute when some other basis for their decision is available has been applied by courts even when the parties waive the consideration of all other issues by their pleadings or stipulations. Iowa Motor Vehicle Assn. v. Board of Railroad Com'rs., 202 Iowa 85, 209 N.W. 511; McCandless v. Campbell, 20 Haw. 404. That universal rule is well exemplified by and explained in detail in the case of Rescue Army v. Municipal Court, 331 U.S. 549, 568, 91 L. Ed. 1666, 1677, which apparently was sent up to and reached the Supreme Court in such a manner that the only matters for its possible consideration were questions concerning the constitutionality of some ordinances of the City of Los Angeles. Justice Rutledge speaking for the court recognized the problem when he said:

> "While therefore we are unable to conclude that there is no jurisdiction in this case, nevertheless compelling reasons exist for not exercising it."

He then stated and analyzed the court's long established policy of strict necessity in disposing of constitutional issues and explained in detail why the court found it necessary to dismiss the appeal and subject petitioner Murdock to the burden of a third trial.

In spite of rather exhaustive research Plaintiff has been unable to find a single case where a court stated that its decision as to the unconstitutionality of a statute was caused by the extent of the statute's violation of the Constitution. On the other hand, many courts of first impression usually assume a statute is constitutional until the contrary is declared by a court of appellate jurisdiction. 16 C.J.S. 303. That rule was enlarged in the New York jurisdiction many years ago and there a court of first instance will not declare a statute unconstitutional except in rare cases involving life and liberty, and where invalidity of the act is apparent on its face. Bohling v. Corsi, 127 N.Y.S. 2d 591, affirmed 306 N.Y. 815, 118 N.E. 2d 823, appeal dismissed 348 U.S. 802, 99 L. Ed. 634.

On the basis of the reasons and law stated above Plaintiff contends that said section 5469 was not such a violation of due process that all assessments made pursuant to it must be deemed invalid.

II

Query: Is it necessary, prior to a decision on the constitutionality of said section 5469, that all of the facts of the case must be determined?

A consideration of all of the merits of the case, in addition to those pertaining to questions of constitutionality, should be made by the court prior to a determination on the constitutionality of the statute because of the aforementioned general rule that the constitutionality of a statute will be passed on only if, and to the extent that, it is directly and necessarily involved in the controversy. Rescue Army v. Municipal Court, supra. If, as Plaintiff contends, the assessment was properly made by reason of the facts of the case determining that Defendant was an obdurate or negligent taxpayer then, under the ruling of Wilder v. Colburn, supra, there will be no necessity for a determination as to the constitutionality of section 5469.

Another rule requiring the determination of all of the facts of the case is the universal rule that a revenue statute may only be attacked by one who is thereby injured. That rule is clearly demonstrated in Gallup v. Schmidt, 183 U.S. 300, 46 L. Ed. 207, 212, which affirmed the Supreme Court of Indiana (154 Ind. 196, 56 N.E. 443) in its refusal to consider the constitutionality of a tax statute, in regard to notice and hearing, even though the statute appeared clearly unconstitutional as applied to nonresidents. Gallup was a nonresident but he had, while within the taxing county acting as executor for the subject property, received notice and attended the hearing, etc. Gallup attacked the constitutionality of the statute as applied to nonresidents but the court said on page 305:

> "The Supreme Court of Indiana disposed of this contention by holding 'that appellant (Edward P. Gallup) was an official resident of Marion County at the time the proceeding by the auditor was commenced, and therefore within the express terms of the section.'

> "This construction of the section is criticized by the learned counsel of the plaintiff in error as novel, and unsupported by authority. However this may be, it is a construction or application of the statute to the case at hand, and is binding upon us."

Gallup also attacked the constitutionality of the result of that part of the Indiana decision but the court said on page 306:

> "He (Gallup) was in a situation to avail himself of all the rights and privileges he asserts are unjustly denied to nonresidents, and, while himself not aggrieved, he will not be permitted to assail a revenue statute on behalf of others who are making no complaint. The courts are open to those only who are injured."

Consequently, if the court determines that Defendant was obdurate or negligent or determines that the amount of the subject assessment was proper then Defendant has not been injured and no decision need be made on the issue of constitutionality.

Still another rule necessitating a consideration of all of the facts of the case is the rule that when an assessment is determined to have been unconstitutional the relief the taxpayer thereby obtains extends only to the amount of the excess taxes over and above what the amount of taxes would have been if legally assessed. Thus, in speaking of assessments that appeared to have been made in a discriminatory manner, the court in City of Wichita Falls v. J. J. & M. Taxman Refining Co., 74 S. W. 2d 524, on page 529 said:

> "We believe it is clearly deductible from all the decisions that the right of relief from assessments made in violation of the constitutional guaranty of equality of taxation, or the denial of the due process of law clause in the Fourteenth Amendment of the Federal Constitution, in failing to give the owner an opportunity to be heard on a proposed assessment, is limited to the excess over and above the amount properly assessable on an equality bases...."

The court then refused to give any tax relief for the reason that the taxpayer failed to give sufficient basis for determining with reasonable certainty the amount of excess taxes over and above what it legally owed. Certiorari to the U. S. Supreme Court was denied, 296 U.S. 587, 80 L. Ed. 415. That rule is the reason the court in Central of Georgia v. Wright, supra, concluded by saying:

> "The judgments of the Supreme Court of Georgia are reverse and the cases remanded for further proceeding not inconsistent with this opinion."

The aforementioned rule, undoubtedly, is one of the reasons our statute pertaining to appeals from the Tax Appeal Court to the Supreme Court, section 5214 Revised Laws of Hawaii 1945, in part states:

> "The appeal shall be considered and treated for all purposes as a general appeal and shall bring up for determination all questions of fact and all questions of law, including constitutional questions, involved in the appeal."

So also, prior to that statute, when the court in Tax Assessment Appeals, 11 Haw. 235, on page 236 said:

> "In other words, this court while giving a certain weight to a decision of a tax appeal court, is authorized to form its own estimate of the proper assessment as shown by the evidence."

Plaintiff further contends that the facts of the case will show that Defendant, in making the sales upon which the subject assessment was made, appears to have had the status of a peddler who transports his merchandise with him for immediate delivery, having no fixed place of business within the Territory. The taxation of sales by such peddlers is not prohibited by the Constitutions provisions pertaining to interstate commerce. Caskey Baking Co. v. Virginia, 313 U.S. 117, 85 L. Ed. 1223. On pages 2 and 3 of the memorandum filed with his motion Defendant alleges the reasons for not filing his returns as clearly required by the law, in that he was advised that his sales were not subject to Territorial taxes and that he had enjoyed "years of immunity". In reply Plaintiff states that the husband of Defendant's niece was an employee of the tax office and, in part, because of that person's unlawful meddling in defendant's tax matters he resigned, as requested, from the tax office. The facts of the case will also clearly prove that Defendant knew of our general excise tax law, and its applicability to his activities, prior to the period of time covered by the subject assessment.

For the above stated reasons and law Plaintiff contends that the court should determine all of the facts of the case prior to making a decision as to the constitutionality of said section 5469, if that should be necessary.