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TAX APPEAL COURT
STATE OF HAWAII
FILED
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IN THE TAX APPEAL COURT OF THE STATE OF HAWAII

In the Matter of the Tax Appeal) Case No. 1785

of)

WILLIAM J. McKINLEY and)
MARGARET S. McKINLEY,)

Appellants.)

In the Matter of the Tax Appeal) Case No. 1786

of)

JOHN M. McKINLEY and)
SYLVIA C. McKINLEY,)

Appellants.)

In the Matter of the Tax Appeal) Case No. 1787

of)

CHARLES B. SHRYOCK and)
MARYBETH SHRYOCK,)

Appellants.)

In the Matter of the Tax Appeal.) Case No. 1788

of)

SCOTT McCORMAC)

Appellant.)

| | | |
|-------------------------------------|---|--------------------|
| In the Matter of the Tax Appeal |) | Case No. 1789 |
| |) | |
| of |) | |
| VARI McKINLEY aka VARI McCORMAC, |) | |
| |) | |
| Appellant. |) | |
| _____ |) | |
| In the Matter of the Tax Appeal |) | Case No. 1790 |
| |) | |
| of |) | |
| MAYTOR H. McKINLEY, JR., |) | |
| |) | |
| Appellant. |) | |
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| In the Matter of the Tax Appeal |) | Case No. 1791 |
| |) | |
| of |) | |
| ESTATE OF MAYTOR H. McKINLEY |) | |
| |) | |
| Appellant. |) | |
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| In the Matter of the Tax Appeal |) | Case No. 1792 |
| |) | |
| of |) | |
| UTTER McKINLEY MORTUARIES, |) | |
| |) | |
| Appellant. |) | DECISION AND ORDER |
| _____ |) | |

DECISION AND ORDER

This is a Hawaii net income tax case.

The facts in this case are as set forth in the Stipulated Facts and exhibits appended thereto filed herein on September 8, 1978, and the Supplemental Stipulated Facts and exhibits appended thereto filed herein on October 3, 1978. All of the foregoing are incorporated herein by reference and made a part of this decision.

A summary of the material facts are as follows:

All Appellants herein are non-residents of the State of Hawaii. Subsequent to January 28, 1969 and during the time relevant to the appeals herein, Appellants received quarterly payments of trust distributions from Bishop Trust Company, Ltd. (hereinafter "Bishop Trust"). The Department of Taxation, State of Hawaii, by notices of assessments (Exhibits L-1 through T-7) assessed to Appellants Hawaii net income taxes computed upon the amount of such trust distributions.

The factual bases underlying the subject trust distributions are as follows:

On or about February 28, 1962, Hawaiian Guardian, Ltd. (hereinafter "Guardian") fka Hawaiian Memorial Life Plan Limited, incorporated with the purpose of engaging in the business of selling funerals to the public on a pre-need basis. Incident to its business Guardian established a Clearing Trust and arranged for establishment of individual funeral service fund trusts with Bishop Trust as trustee. Bishop Trust is a Hawaii corporation organized and doing business in the State of Hawaii. The trusts have been administered by Bishop Trust in the State of Hawaii. Guardian's beneficial interest in both the Clearing Trust and the individual funeral service fund trusts consisted of the right to receive all realized net income, gain and increment on the trust corpus.

Trustee Bishop Trust was given full powers of investment, and was given exclusive possession, control, custody and management of the trust corpus.

Guardian liquidated and dissolved on or about January 28, 1969, at which time the following Appellants, among other persons, owned its shares of stock:

William J. McKinley
John M. McKinley
Marybeth Shryock fka MaryBeth McKinley
Scott McCormac
Vari McKinley nka Vari McCormac
Maytor N. McKinley, Jr.
Maytor H. McKinley (deceased, Estate of)
Utter McKinley Mortuaries

Pursuant to Guardian's Agreement and Plan of Dissolution (Exhibit A), Guardian executed to each shareholder, including Appellants herein, an Assignment of Beneficial Interest of Trust (Exhibits D through K) on January 28, 1969 whereby Guardian assigned to its shareholders pro-rata Guardian's beneficial interest in the Clearing Trust and the individual funeral service fund trusts administered by Bishop Trust. Consequently, the Guardian shareholders collectively became beneficiaries of all of the net income, gains, increases, and increments of the trust corpus and became entitled to receive quarterly distributions of trust income.

During the time relevant to the appeals herein Bishop Trust distributed to Appellants quarterly payments of trust net income consisting of interest and dividends derived from the investment of the trust corpus in united States Treasury bills, bank certificates of deposit, preferred stock, and common stock.

Pursuant to HRS § 235-114 Appellants appealed the Notices of Income Tax Assessment (Exhibits L-1 through T-7) to the Board of Review for the First Taxation District (hereinafter "Board").

In its decisions dated May 11, 1978, the Board determined that the subject trust distributions were subject to the Hawaii net income tax and held that the following amounts of Hawaii net income taxes were due and owing from Appellants, plus interest.

| <u>Appellants</u> | <u>Amount of Hawaii net income tax liability</u> |
|--|--|
| William J. and Margaret S. McKinley | \$5,511.74 plus interest |
| John M. and Sylvia C. McKinley | \$4,923.46 plus interest |
| Charles B. and MaryBeth Shryock | \$1,667.24 plus interest |
| Scott McCormac | \$3,390.49 plus interest |
| Vari McKinley aka Vari McCormac | \$3,802.84 plus interest |
| Maytor H. McKinley, Jr. | \$4,075.88 plus interest |
| Estate of Maytor H. McKinley | \$8,092.00 plus interest |
| Utter McKinley Mortuaries | \$4,041.56 plus interest |

Pursuant to HRS § 232-17 Appellants now appeal the Board's decisions to this Court by Notices of Appeal filed herein on June 9, 1978. Appellee-Director of Taxation (hereinafter "Director") filed his answers thereto on June 29, 1978. Appellants filed their Amended Notices of Appeal on August 9, 1978; Director filed his answers thereto on August 21, 1978 praying inter alia that the amount of taxes plus interest found to be due the State by the Board be deemed government realizations. Director did not appeal any portion of the Board's findings.

By written stipulation for consolidation filed herein on September 12, 1978, the parties herein through their respective attorneys consolidated the instant appeals, T.A. Nos. 1785 through 1792, for the purpose of determining the common question of law, to wit, whether or not the distributions of certain trust income received by Appellants herein from the Bishop Trust Company, Ltd. are subject to the Hawaii net income tax.

The question of law consolidated for decision is the sole question raised by Appellants' Notices of Appeal, amendments thereto, and Director's answers thereto.

The Court hereby affirms the decisions of the Board of Review of the First Taxation District and holds that the subject trust distributions received by Appellants are subject to the Hawaii net income taxes.

HRS § 235-4(e)(2) imposes the Hawaii net income tax upon trust beneficiaries. It essentially provides that trust income distributed to trust beneficiaries is subject to the Hawaii net income tax if such income would be taxable to the trust beneficiary if received directly by the beneficiary rather than through the trust.

HRS § 235-4(b), which imposes the Hawaii net income tax upon non-residents such as Appellants herein, provides in pertinent part that "the tax applies to income received or derived from property owned . . . and any and every other source in the State."

The trust distributions at issue herein are attributable to realized income in the form of interest and dividends derived from investment of the trust corpus in United States Treasury bills, bank certificates of deposit, preferred stock, and common stock. These items of intangible personal property were in the exclusive possession, control, custody and management of Bishop Trust; therefore, their business situs is in the State of Hawaii. Carter v. Hill, 31 H. 264 (1930), aff'd 47 F.2d 869, cert. den. 284 U.S. 625 (1931); De Ganay v. Lederer, 250 U.S. 376 (1919).

If Appellants owned these items of intangible personal property they would be deemed to be "property owned . . . in the State" within the meaning of HRS § 235-4(b) inasmuch as the business situs of such properties is in the State of Hawaii. Carter v. Hill, 31 H. 264 (1930), aff'd 47 F.2d 869, cert. den. 284 U.S. 625 (1931); De Ganay v. Lederer, 250 U.S. 376 (1919).

Therefore, income derived therefrom would be subject to the Hawaii net income tax. Accordingly, pursuant to HRS § 235-4(e)(2), Appellants are subject to the Hawaii net income tax upon the receipt of the subject trust distributions.

WHEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the decisions of the Board of Review of the First Taxation District are affirmed and that judgment be entered for the Appellee-Director and against Appellants in the amounts of Hawaii net income taxes determined by the Board to be due the State, plus interest accruing until date of payment per HRS § 231-39.

Dated: Honolulu, Hawaii, Feb. 1, 1979.

Yusutake Sakamoto



Judge of the above-entitled Court

APPROVED AS TO FORM:

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