

TAX APPEAL COURT
STATE OF HAWAII
JAMES A. SMITH
Clerk

NO. 1228

IN THE TAX APPEAL COURT

James A. Smith
Clerk

STATE OF HAWAII

MURPHY MOTORS, LIMITED,
Plaintiff,
vs.
RALPH W. KONDO, Director
of Taxation,
Defendant.

9/11/90

FINDINGS OF FACT

and

CONCLUSIONS OF LAW

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A TRUE COPY. ATTEST WITH
THE SEAL OF SAID COURT.

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MURPHY MOTORS, LIMITED,)
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) Plaintiff,)
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) vs.)
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RALPH W. KONDO, Director)
of Taxation,)
) Defendant.)
)

FINDINGS OF FACT

and

CONCLUSIONS OF LAW

This case came on for hearing on an Agreed Statement of Facts and the Court having duly considered the briefs of counsel, hearing arguments thereon and otherwise being fully advised in the premises makes and files the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. Appellant Taxpayer is a corporation duly organized and existing under the laws of the State of Hawaii engaged in the business of selling and servicing new and used cars. The Taxpayer also performs service and repair work on motor vehicles, including warranty work for the manufacturer of its new cars.

2. Upon the purchase of each new car, the purchaser receives a Manufacturer's Warranty against defects in material and workmanship. Under the terms of the warranty, the manufacturer is obligated to the purchaser to repair or to replace any part or parts which, upon inspection by the manufacturer, are found to be defective. The warranty obligation extends from the manufacturer to the purchaser and the Taxpayer is involved only to the extent of performing the work necessary to repair or to replace defective parts as authorized by the manufacturer.

3. Where the repair or replacement of defective parts is made by the Taxpayer at its place of business, there is no charge made to the purchaser either for the replacement part or for labor.

4. For work performed under the Manufacturer's Warranty, the manufacturer reimbursed the Taxpayer in the form of credits as follows:

a. For parts and accessories, Taxpayer was credited an amount equal to the then amount paid by dealers to the manufacturer for such parts and accessories, plus twenty per cent (20%). The twenty per cent represented costs related to the carrying of excess inventory of parts such as rent, employee wages and benefits and interest.

b. For labor, the Taxpayer was credited on the basis of time allotments established by the manufacturer for each type of warranty work. The

time allotment was then multiplied by an hourly rate of \$7.25. The hourly rate was also established by the manufacturer.

5. The total amount of credits received as reimbursements by the Taxpayer for parts and labor in the performance of warranty work were as follows:

	<u>1964</u>	<u>1965</u>	<u>Total</u>
Parts and Accessories	\$ 68,319.53	\$23,149.85	\$ 91,469.38
Labor	<u>132,030.98</u>	<u>44,738.28</u>	<u>176,769.26</u>
TOTAL	\$200,350.51	\$67,888.13	\$268,238.64

6. The evidence shows that the additional general excise tax assessed upon credits received from the performance of warranty work alone is \$9,388.35. However, this amount was included as part of \$12,236.15 of additional general excise taxes assessed against the Taxpayer for income derived from the sale of service cars, sales bonuses, and trade-in and exempt income which were disallowed. The Taxpayer was given a credit of \$3,458.60 representing an overpayment of previous years general excise taxes. The amount of taxes in dispute, therefore, is \$8,777.55 which the Taxpayer paid under protest pursuant to Section 40-35, Hawaii Revised Statutes.

CONCLUSIONS OF LAW

1. The Taxpayer contends that the amount of credits it received from the manufacturer representing reimbursements for labor and parts expended in the performance of warranty claims do not constitute gross income under Section 117-17.1 of the Revised Laws of Hawaii 1955, as amended. (The applicable statutory section during the tax period in question 1964-65. The section, as amended, has since been further amended and redesignated as Section 237-20, Hawaii Revised Statutes.)

2. Section 117-17.1, Revised Laws of Hawaii 1955, as amended, relating to certain general principles, provides, in pertinent part:

"Even though a business has some of the aspects of agency it shall not be so regarded unless it is a true agency. Without prejudice to the generality of the foregoing, the reimbursement by one person of the amount of costs incurred by another constitutes gross income of the latter, unless the person making the reimbursement was himself, as principal, liable in that amount to the third party who furnished the property, services and the like for which the costs were incurred. . . ."

a. A true agency always imports commercial or contractual dealings between two parties by and through the medium of another. See 3 Am.Jur.2d, Agency, §§ 1, 2. In the instant case, there is no true agency between the Taxpayer and the manufacturer of its new cars. While there is evidence that the manufacturer authorized the Taxpayer to perform the repair or replacement work which the manufacturer was obligated to do under the terms of the warranty, this fact of itself is insufficient to establish a true agency.

b. That portion of Section 117-17.1 which provides "without prejudice to the generality of the foregoing, the reimbursements by one person of the amount of costs incurred by another constitutes gross income of the latter" states the general rule with respect to the taxability of reimbursements in this case. The exception follows, however, that such reimbursements must be based upon costs incurred by the agent on behalf of his principal for services or property furnished to him by a third party and for which the principal would be liable in that amount.

The Court finds that there was no property or service furnished to the Taxpayer by the purchaser (third party). Although the Taxpayer argues that the phrase "and the like" would mean to include the consideration furnished by the purchaser as purchase price for the car, this section of the law does not include the furnishing of money. This section was intended to cover the flow of property or service from a third party (purchaser) to the agent (Taxpayer) for which the agent (Taxpayer) paid a monetary consideration and was then subsequently reimbursed by his principal (manufacturer).

3. Having determined that the credits received by the Taxpayer as reimbursements are taxable gross income under the provisions of Section 117-17.1, it is not necessary to

get to the point whether or not Section 237-20, Hawaii Revised Statutes, is an amendment of Section 117-17.1 or whether or not it is merely a clarification of the section. Even if Section 237-20 were deemed to be an amendment, the Court is of the opinion that the term "cost" as used in said Section 237-20 actually means a monetary amount paid out by the agent for property or services furnished by a third party. If this question were reached, however, the Court would use the rule of strict construction against the government and the term "cost" would be construed in a broader sense than the construction urged upon this Court by the Director of Taxation. Section 117-17.1 is a tax imposition statute and is not, as the contention is made by the Director, an exemption statute.

4. The Taxpayer urges that the reasoning in Re Taxes, Gay & Robinson, 40 Haw. 722 (1955) should be controlling in this case. However, Gay & Robinson was decided in 1955 and the legislature did not enact Section 117-17.1 into law until 1957, two years later, as Act 34, S.L.H. 1957. In view thereof, it cannot be said that Gay & Robinson should be controlling in the interpretation of Section 117-17.1.

5. The facts in Loel Lust Chevrolet Co. v. Commissioner of Revenue, 158 N.W.2d. 603 (S.D. 1968), are analogous with the case at bar. In that case, reimbursements received in the form of credits for the cost of labor expended in replacing and repairing defective automobile parts pursuant to a manufacturer's warranty were held to be taxable

gross receipts. Although no tax was claimed for the reimbursement of parts, gross receipts from the sale of tangible personal property were taxable under another section of the South Dakota Retail Sales and Service Tax Act not involved in the proceedings.

6. The reimbursements are taxable as gross income as provided in Section 117-17.1, Revised Laws of Hawaii 1955, as amended. (The section has since been further amended and redesignated as Section 237-20, Hawaii Revised Statutes.)

7. Judgment will be entered for the Director of Taxation and the sum of \$8,777.55 shall be, and is hereby made, a lawful government realization.

DATED: Honolulu, Hawaii, September 10, 1970.

Dick Yim Wong

Judge of the above-entitled court



APPROVED AS TO FORM:

for *(s) Paul L. Wilson*
JULIAN H. CLARK 717-0
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1100 First Hawaiian Bank Bldg.
Honolulu, Hawaii

Attorney for Appellant-Taxpayer

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J U D G M E N T

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Attorney for Director
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[Signature]
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JUDGMENT

This case having been heard on an Agreed Statement of Facts and the Court having duly considered the briefs and having heard arguments thereon by counsel; and the Court after due deliberation having made and filed its findings of fact and conclusions of law on the date hereof,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the assessments of additional general excise taxes against Appellant herein were made in accordance with law, and that the sum of \$8,777.55 heretofore paid by the Appellant-Taxpayer MURPHY MOTORS, LIMITED, be and is hereby made a lawful government realization.

Dated at Honolulu, Hawaii, this 10 day of

Digitized
~~August~~, 1970.

Dick Yin Wong

Judge of the above entitled Court



APPROVED AS TO FORM:

for *Julian H. Clark*
JULIAN H. CLARK 717-0

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Attorney for Appellant-Taxpayer