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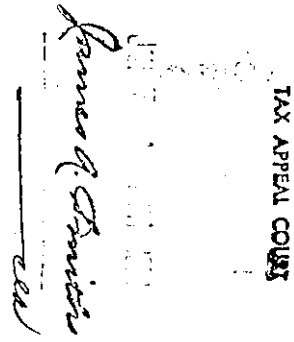

IN THE TAX APPEAL COURT

STATE OF HAWAII

VLADIMIR OSSIPOFF & ASSOCIATES, INC., a Hawaii corporation, Plaintiff, vs. RALPH W. KONDO, Director of Taxation, Defendant.	CASE NO. 1450 FINDINGS OF FACT AND CONCLUSIONS OF LAW

FINDINGS OF FACT AND CONCLUSIONS OF LAW

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

FINDINGS OF FACT

1. Plaintiff Taxpayer is a professional corporation duly organized and existing under the laws of the State of Hawaii licensed to do business at all times pertinent hereto pursuant to and in compliance with the

provisions of Chapter 237, Hawaii Revised Statutes.

2. The Taxpayer is engaged in the practice of architecture and for this purpose is duly registered under the provisions of Chapter 464, Hawaii Revised Statutes.

3. Whenever architectural services are to be performed, the Taxpayer enters into contracts with the owners using standard forms of the American Institute of Architects. The services to be performed include the necessary conferences; the preparation of preliminary studies; working drawings and specifications; the preparation of large scale and full size detailed drawings; the furnishing of architectural, structural, mechanical and electrical work; assistance in the drafting of forms of proposals and contracts; the issuance of certificates of payment; the keeping of accounts; the general administration of the business and supervision of the work. The Taxpayer is also required to make periodic visits to the project site and to conduct inspections. For these services, the architect is paid an agreed upon fee. The contract form also provides that the Taxpayer shall be reimbursed for certain incidental expenses in connection with the project such as the expenses of transportation and living when traveling, long distance telephone calls and telegrams. The Taxpayer was also to be reimbursed for the expenses of reproduction, postage and handling of drawings and specifications.

4. In performing architectural services during the tax period involved in this appeal, the Taxpayer has engaged the services of a construction consultant for the preparation of construction cost estimates and the services of an industrial designer for the preparation and furnishing of interior signs.

5. The Taxpayer has incurred incidental expenses in connection with its performance of the architectural services such as air travel expenses, U-Drive rental charges, living and traveling expenses for projects situated on the neighbor islands or on the mainland; long distance telephone calls, telegrams, and expenses for duplicating blue prints and specifications.

6. For the period December 1, 1968, through November 30, 1971, the Taxpayer was assessed additional general excise taxes, together with interest, in the total amount of $1,243.09, as follows:

Reimbursed expenses determined to be gross receipts	$904.02	
Interest	117.17	$1,021.19
Disallowed subcontractor's deductions	202.36	
Interest	19.54	221.90
TOTAL		$1,243.09

7. Notice of the additional taxes assessed to the Taxpayer was given on May 17, 1973. The Taxpayer paid the assessed taxes under protest on June 5, 1973.

CONCLUSIONS OF LAW

1. The Taxpayer makes two contentions. First, that the Director of Taxation has improperly disallowed the subcontractor's deduction allowed by HRS Section 237-13(3)(B). The Taxpayer contends that a construction consultant who renders cost estimates for the architectural trade and an industrial designer who prepares

and furnishes the architectural trade with interior signs are contractors within the purview of Section 237-13(3)(B) because they are professional engineers. Thus, the Taxpayer argues that the amounts paid to the construction consultant and to the industrial designer have been properly deducted from the Taxpayer's gross income in computing its general excise taxes.

Exemptions from taxation are to be construed strictly against the Taxpayer and when a taxpayer seeks a reduction in taxes, the taxpayer is seeking an exemption. Honolulu Star-Bulletin, Limited v. Burns, 50 Haw. 603 (1968). The Taxpayer, therefore, must clearly show that it is entitled to the subcontractor's deduction. The burden, thus, is upon the Taxpayer to show by clear proof that construction consultants and industrial designers are professional engineers.

Section 237-13(3)(B) provides, in pertinent part:

> "In computing the tax levied under this paragraph (3) or section 237–16, there shall be deducted from the gross income of the taxpayer so much thereof as has been included in the measure of the tax levied under paragraph (3)(A) or section 237-16, on another taxpayer who is a contractor, as defined, in respect of his business as such, if the tax on the amount so deducted has been paid by the other person, or has been withheld by the taxpayer and shall be paid over by him to the assessor at the time of filing the return, . . ."

The term "contractor" has been defined in HRS Section 237-6, as amended, to include:

> "(1) Every person engaging in the business of contracting to erect, construct, repair or improve buildings or structures, of any kind or description, including any portion thereof, or to make any installation therein, or to make, construct, repair or improve any highway, road, street, sidewalk,

> ditch, excavation, fill, bridge, shaft, well, culvert, sewer, water system, drainage system, dredging or harbor improvement project, electric or steam rail, lighting or power system, transmission line, tower, dock, wharf, or other improvements; and
>
> (2) Every person engaging in the practice of architecture, professional engineering, land surveying, and landscape architecture, as defined in section 464-1."

The Court finds the definition to be plain and unambiguous and conveys a clear and definite meaning as to who are contractors. Section 237-6, therefore, is not open to construction. The section does not include construction consultants and industrial designers within its enumeration. Furthermore, construction consultants and industrial designers do not fall within the class of persons engaging in the business of erecting, constructing, repairing or improving the public works type of improvements described in the section. The Court finds that construction consultants and industrial designers are not, by law, professional engineers, but that they provide ancillary services to the architectural and engineering professions.

2. The Taxpayer next contends that the payments it received as reimbursements for the expenses incurred in connection with the performance of its architectural services constitute non-taxable reimbursements within the purview of HRS Section 237-20.

Section 237-20 provides:

> "A person or company having shareholders or members (a corporation, association, group, trust, partnership, joint advanture, or other person) is taxable upon its business with them, and they are taxable upon their business with it. A person or company, whether or not called a cooperative, through which shareholders or members are pursuing a common objective (for example,

> the obtaining of property or services for their individual businesses or use, or the marketing of their individual products) is a taxable person, and such facts do not give rise to any tax exemption or tax benefit except as specifically provided. Even though a business has some of the aspects of agency it shall not be so regarded unless it is a true agency. The reimbursement of costs or advances made for or on behalf of one person by another shall not constitute gross income of the latter, unless the person receiving such reimbursement also receives additional monetary consideration for making such costs or advances."

That portion of Section 237-20 which provides that "[T]he reimbursement of costs or advances made for or on behalf of one person by another shall not constitute gross income of the latter . . ." states the general rule with respect to the taxability of reimbursements in this case.

The Court finds that the expenses incurred by the Taxpayer in this appeal such as expenses for transportation and living when traveling, long distance telephone calls and telegrams, the expenses of reproduction, postage and handling of drawings and specifications incurred in connection with the project for which the Taxpayer was engaged to perform architectural services, are incidental expenses which the Taxpayer must necessarily incur for the production of income. The expenses were incurred pursuant to the Taxpayer's obligation to render architectural services for the owner and the expenses were necessarily incurred in order that the Taxpayer may complete performance of these architectural services. The Taxpayer argues that the services for which the expenses were incurred were performed by third parties, consequently, the payments received by the Taxpayer do not constitute

gross income but are non-taxable reimbursements. The Court finds that these services rendered by third parties are ancillary services furnished to the Taxpayer and are not the reimbursements contemplated by HRS Section 237-20. The Court, therefore, finds that the expenses were incurred for the Taxpayer's own benefit and on its own behalf, not on behalf of the owner. All amounts received from the owner as payments for these expenses, consequently, constitute taxable gross income. In this wise, the status of the Taxpayer is no different from any other taxpayer engaged in business which incurs incidental expenses in connection with the production of income. They may not deduct the expenses. The Hawaii General Excise Tax Law taxes all gross income and gross receipts without deductions of any kind whatsoever. HRS § 237-3. In view of the foregoing, it is not necessary to go into the question whether or not the Taxpayer also received additional monetary consideration.

3. The Court agrees with the Director that while the parties may segregate these incidental expenses in the contract as reimbursable expenses, the designation is not controlling as to whether or not they constitute non-taxable reimbursements for purposes of Section 237-20. Where tax avoidance schemes are involved, the Court will look through the form used by the parties and consider the substance of the transaction. The name attached by the parties will be ignored. In re Taxes, Ulupalakua Ranch, 52 Haw. 557 (1971). The Court finds in this case that the reimbursements have been segregated as a matter of form only but in substance the expenses have been incurred by

the Taxpayer for his own benefit and on his own behalf, as necessary expenses for the production of income.

4. The Taxpayer urges that the case of Aloha Motors, Inc. and Edward R. Bacon, Ltd. v. Ralph W. Kondo, T. A. Nos. 1298 and 1309 decided June 4, 1973, should be made to apply to exempt the payments as non-taxable reimbursements. The Court concludes that Aloha Motors, Inc. does not apply to the facts in this case.

5. The reimbursements are taxable as gross income and do not constitute non-taxable reimbursements within the purview of HRS Section 237-20.

6. Judgment will be entered for the Director of Taxation and the sum of $1,243.09 shall be, and is hereby made, a lawful government realization.

Dated: Honolulu, Hawaii, Jan. 7, 1974.

Masaoka Takashima (SEAL)
Judge of the above entitled Court

APPROVED AS TO FORM:

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

Clerk/Registrar