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IN THE TAX APPEAL COURT OF THE STATE OF HAWAII

IN THE MATTER OF THE TAX APPEAL of PACIFIC LAUNDRY CO., LTD.	CASE NO. 1864 DECISION AND ORDER

DECISION AND ORDER

These proceedings involve the assessment by the Director of Taxation of additional general excise taxes imposed pursuant to the provisions of HRS Chapter 237, the Hawaii General Excise Tax Law.

The facts in this case are set forth in the Stipulation of Facts on file with the record of this appeal and are incorporated herein and by reference made a part of this Decision.

Briefly, the facts are as follows:

The Taxpayer is engaged in the business of furnishing and providing laundry, dry cleaning and linen supplies. It has entered into agreements with various hotels for the purpose of furnishing and providing laundry, dry cleaning and linen supplies to the hotels, their employees and guests. The agreements, with the exception of the Princess Kaiulani

Hotel and the Prince Kuhio Hotel, are oral aqreements.

In a typical situation, the Taxpayer furnishes the hotels with the required laundry slips and laundry bags althouqh many of the hotels may provide their own laundry bags. Each of the laundry slips identifies the name of the hotel and lists the various items of clothing with a price list after each item. The slip has imprinted at the top the Taxpayer's name and identifies the Taxpayer as being the entity that performs the laundry and dry cleaning service. Whenever a hotel guest desires laundry or dry cleaning work to be done, the list is completed and attached to the items of clothinq, etc. to be laundered or dry cleaned. The guest may either ask the bell boy to pick up the laundry or he may himself take it to the desk for pickup. Upon completion of the laundry or dry cleaning, the Taxpayer delivers it to the hotel. The laundry is left at the desk whereupon either the bell boy may make delivery to the guest's room or the guest may himself pick up the laundry at the desk. All pickups and delivery from and to the hotel are made by employees of the Taxpayer.

The Taxpayer bills the hotel for the total amount of the laundry and dry cleaning charges. The amount of the charges is then added to the guest's hotel bill. All payments are made to the hotel. All uncollectible accounts are charged to the Taxpayer. The hotels are not responsible for any claim for loss or damage to the items of laundry or dry cleaning other than for their own negligence or the negligence of their employees. The liability is assumed by the Taxpayer.

The hotel retains an average of 25 - 35% of the laundry and dry cleaning charges as compensation for services

rendered. The balance is remitted to the Taxpayer. The compensation is termed as “commissions” or “discounts” in the Taxpayer's books and records. In the case of the Princess Kaiulani Hotel, the written agreement designates the hotel as being the agent of the Taxpayer.

In reporting its gross receipts the Taxpayer had deducted the amount of the “commissions” or “discounts” paid to the hotels. In so doing, the Taxpayer has reported only the net amount of its gross receipts for purposes of the Hawaii general excise tax law. The Taxpayer also reports gross receipts derived from the performance of intermediary services. In Schedule A of its annual returns, it has reported under item 6 “Intermediary Services”, an amount of $51,742.70 for tax year 1975; $50,349.63 for tax year 1976; and $44,162.78 for tax year 1977. The amounts have been assessed at the one-half per cent rate, the appropriate rate for intermediary services. Stipulation of Facts, Exhibits G-1 to G-3.

The Director has disallowed the deduction of “commissions” or “discounts” and has included these amounts in recomputing the Taxpayer's gross income. The deductions have been disallowed because the definition of gross income prescribed in HRS Section 237-3 does not allow for their deduction and the amounts are not otherwise exempt from general excise taxation.

By its Notice of Appeal, the Taxpayer alleges it disputes the entire amount of the assessments and contends it is not properly taxable for any of the amounts upon which additional general excise taxes have been assessed. It further contends the assessments violate the provisions of

HRS Sections 237-13(6) and 237-7. In support thereof, in its opening and Answering Memoranda, the Taxpayer contends it is performing intermediary services within the purview of HRS Section 237-13(6).

The Court agrees with the Director's contention that "commissions" or "discounts" herein involved are not properly deductible for purposes of computing gross income. HRS Section 237-3 provides that gross income shall include all receipts derived from the taxpayer's trade or business without any deduction of any kind whatsoever. Moreover, the exclusions from gross income enumerated in the Section do not include these commissions and discounts within their exclusion. The Court determines that the "commissions" or "discounts" herein involved are, in fact, compensation for services rendered by the hotels. In Re Taxes, Aiea Dairy, Ltd., 46 Haw. 292 (1963), reh. den. 46 Haw. 403. In addition thereto, the provisions of neither HRS Section 237-7 nor 237-13 (6) exempt the gross receipts from taxation.

The next question arises whether or not the Taxpayer's activities may be classified as intermediary services within the purview of HRS Section 237-13(6).

The Court agrees with the Director's contention that intermediary services are not apposite hereto.

The tax upon persons involved in the furnishing of intermediary services is governed by the provisions of HRS Section 237-13(6). The Section provides:

> "Tax on service business. Upon every person engaging or continuing within the State in any service business or calling not otherwise specifically taxed under this chapter, there is likewise hereby levied and shall be assessed and collected a tax equal to four per cent of the gross income of any such business; provided, however, where any person

> engaging or continuing within the State in any service business or calling renders such services upon the order of or at the request of another taxpayer who is engaged in the service business and who, in fact, acts as or acts in the nature of an intermediary between the person rendering such services and the ultimate recipient of the benefits of such services, so much of the gross income as is received by the person rendering the services shall be subjected to the tax at the rate of one-half of one per cent and all of the gross income received by the intermediary from the principal shall be subjected to a tax at the rate of four per cent.

Thereunder, where a taxpayer engaged in a service business or calling performs such services upon the request of another taxpayer engaged in a service business or calling for the benefit of a third person (the ultimate consumer or customer), the taxpayer who actually performs or renders the services is to be taxed at the lower one-half of one per cent rate upon the entire gross proceeds received for the services. The taxpayer who requests the services is to be taxed at the four per cent rate upon the entire gross proceeds it has received from the ultimate consumer or customer. In the application of the section, there must be the analogue of wholesaler-retailer-customer in the transaction of goods. In order for the taxpayer performing services to qualify for the lower rate he must do so at the request of another taxpayer who is a mere conduit for the service en route to the ultimate recipient, the customer. In Re Taxes, Busk Enterprises, 53 Haw. 518 (1972). In order for the Taxpayer to be taxed at the lower rate for one involved in intermediary services, it must show the presence of the wholesaler-retailer-customer analogue.

It is settled in tax law that taxpayers may arrange their affairs so as to reduce their taxes to the lowest

possible point provided they are within the limitations prescribed by valid statutes and regulations. Superior Oil Company v. State of Mississippi, 280 U.S. 390 (1930); Cudahy v. Wisconsin Tax Commission, 276 N.W. 748 (Wis. 1937); Cliffs Chemical Co. v. Wisconsin Tax Commission, 214 N.W. 447 (Wis. 1927). But where, in arranging its affairs, a taxpayer resorts to a particular form to gain some tax advantage, he will be held to abide by that form and he would be precluded from arguing that the substance of the transaction should prevail over its form. In Re Hawaiian Telephone Company, 57 Haw. 471 (1977); In Re Taxes, Ulupalakua Ranch, 52 Haw. 557 (1971). Moreover, it is not the court's role to rearrange the transaction to the benefit of the taxpayer. Mason v. United States, 453 F.S. 845 (1978).

The Court finds in this case the Taxpayer is engaged in the service business within the purview of HRS Section 237-7 and accordingly is properly to be taxed under the provisions of HRS Section 237-13(6), tax on service business. In furnishing the services to the various hotels, the Taxpayer has entered into agreements which, with the exception of the Princess Kaiulani Hotel and Prince Kuhio Hotel, are oral agreements. The agreement with the Princess Kaiulani Hotel, dated December 13, 1976, expressly provides that the hotel shall be the agent of the Taxpayer:

> "ESTABLISHING AGENT STATUS:
>
> The Hotel will act as agents for the laundry in picking-up and delivering guest laundry/dry cleaning and in billing and collecting of charges incurred by guests for these services. In the event a guest charge for laundry/dry cleaning service is considered, by the Hotel, to be 'uncollectable' (sic), that charge shall be charged back against the current month's guest laundry/dry cleaning payables and will not be the responsibility of this Hotel to pay.

> “It is also understood the Hotel is not in the laundry and dry cleaning business and thus cannot evaluate claims of damaged/lost goods or adjust a disputed charge for service made by the guest against the Laundry. Should such claim or dispute arise, the Hotel will direct the guest to a designated service representative of the Laundry who will be responsible for resolving this matter with the guest directly.
>
> "COMMISSION" 35% on both Laundry and Dry Cleaning."

Looking at the totality of the Taxpayer’s transactions with the hotels and the manner by which laundry service is furnished to the guests of the hotels, the Court finds that the agreement with the Princess Kaiulani Hotel typifies the arrangement the Taxpayer has with the various other hotels and that, accordingly, the hotels act as agents of the Taxpayer. The Taxpayer furnishes all of the required laundry slips; the slips are identified with the Taxpayer’s name imprinted on each slip; all pickups and delivery are made by the employees of the Taxpayer. Dependent upon arrangements made with the hotel, the laundry may be picked up or delivered by the hotel bell boy or the guest may, himself, either take the laundry to the desk or pick up the completed laundry at the desk. Other than for the negligence of the hotel or the negligence of its employees, the hotel is neither liable nor responsible to the guest for any loss or damage. All claims for losses or charges are directed to the Taxpayer. All uncollectible accounts are charged to the Taxpayer. The hotels are compensated for the services they render on behalf of the Taxpayer. Under the circumstances, the Court determines the hotels are acting under the authority of, and on behalf of the Taxpayer. They also handle the billing and collection for and on behalf of the Taxpayer and render

an account thereof to the Taxpayer. In so doing, there results a fiduciary relationship between the Taxpayer and the hotel that the hotel shall act on the Taxpayer's behalf and subject to the control and consent of the Taxpayer to so act. Economic Research Analysis, Inc. v. Brennan, 232 So.2d 219 (Fla. 1970); Electric Power Board of the Metropolitan Government of Nashville and Davidson County v. Woods, 558 S.W.2d 821 (Term. 1977). In Re Taxes, Aiea Dairy, Ltd., 46 Haw. 292 (1963), reh. den. 46 Haw. 403.

The Court agrees with the Director that by so doing, the Taxpayer has rearranged its affairs so that the wholesaler-retailer-customer analogue required by Busk is not apposite hereto. An agency may be defined as the relation which results where one person, called the principal, authorizes another, called the agent, to act for him with more or less discretionary power, in business dealings with third persons. Economic Research Analysis, Inc. v. Brennan, supra. This fiduciary relationship is absent from the wholesaler-retailer-customer analogue and thus is readily distinguishable from transactions involving the furnishing of intermediary services.

The Court further agrees with the Director that the Taxpayer created the relationship with due deliberation and with full knowledge of the benefits of being taxed under the intermediary services provisions. This fact is evidenced by the Taxpayer having also reported other income as constituting gross proceeds derived from the performance of intermediary services. As hereinabove noted, the Taxpayer has reported gross receipts in the amount of $51,742.70 for tax year 1975; $50,349.63 for tax year 1976;

and $44,162.78 for tax year 1977. By rearranging its affairs the Taxpayer reported only the net amount of its gross proceeds, after deduction for the compensation paid to the hotels and thereby sought a tax advantage. In light thereof, the Taxpayer must accept the consequences of its chosen form. He may not argue that substance should prevail over the form of the transaction. In Re Hawaiian Telephone Company, 57 Haw. 471 (1977).

The rule is settled in this State that when a taxpayer seeks a benefit from the taxing laws of the State, the benefit is in the nature of an exemption and the courts will construe the statute strictly against the taxpayer. In Re Pacific Marine & Supply Co., 55 Haw. 572 (1974); Honolulu Star-Bulletin, Limited v. Burns, 50 Haw. 603 (1968). In this case, by seeking the benefit of a lower tax liability, the Taxpayer is seeking an exemption from the taxing laws. The Taxpayer must, therefore, point to the express constitutional or statutory provision which entitles it to the exemption or deduction and it must establish by clear proof that it comes within the scope, operation and contemplation of the exemption. Whenever any doubt arises, it is to be resolved against the Taxpayer. In Re Perry, 36 Haw. 340 (1943); In Re Yerian, 35 Haw. 855 (1941) aff'd 130 F.2d 786. The Taxpayer has failed to meet this burden.

IT IS ACCORDINGLY ADJUDGED, ORDERED AND DECREED that the Director of Taxation properly disallowed the deduction of commissions and discounts in recomputing the Taxpayer's gross income and that the additional general excise taxes assessed at the four per cent rate are proper and valid. The Taxpayer is not engaged in the furnishing or performance

of intermediary services within the purview of HRS Section 237-13(6). The additional taxes paid herein are properly deemed government realizations.

Dated: Honolulu, Hawaii, JAN 14 1980.

Yasutaka Fukushima (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.
James A. Smith
Deputy Clerk