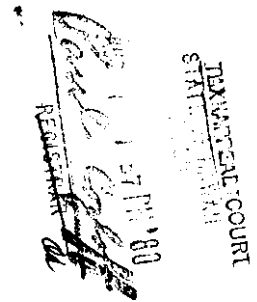


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INC.



IN THE TAX APPEAL COURT OF THE STATE OF HAWAII

In the Matter of the Tax Appeal)	CASE NO. ¹⁸⁷⁵ 1865
of)	
PACIFIC MACHINERY, INC.)	FINDINGS OF FACT AND
_____)	CONCLUSIONS OF LAW;
)	JUDGMENT

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This case came on for decision on a Stipulation of Facts agreed to by the parties, and the Court, having duly considered the evidence and 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. Pacific Machinery Inc. ("Taxpayer") is a corporation duly organized and existing under the laws of the State of Hawaii with its principal place of business in Honolulu, Hawaii.
2. The Taxpayer sells and services heavy construction equipment.
3. Caterpillar Tractor Corporation ("Caterpillar") is a manufacturer and seller of heavy construction equipment.

4. Under a Sales and Service Agreement ("Agreement") with Caterpillar, the Taxpayer is, and at all relevant times was, the exclusive dealer and distributor for the products of Caterpillar in Hawaii.

5. The Agreement provides that Caterpillar shall promote and advertise its products at its own expense as it sees fit.

6. The Taxpayer and Caterpillar have agreed to a pro rata sharing and reimbursement of certain costs for advertisements approved by Caterpillar. Under this cooperative advertising agreement, the Taxpayer invoices Caterpillar for a portion of the advertising expenses incurred on behalf of Caterpillar's products. Caterpillar's share of such costs is 50% of the amounts billed to the Taxpayer by third parties for advertising Caterpillar's products.

7. The Taxpayer annually submits to Caterpillar a form of document titled "Request for Annual Space and Broadcast Advertising Cooperation" ("Request") describing proposed advertisements of Caterpillar products, the media to be used, and estimated costs, including third party services required to create, design or place the advertisements.

8. The Request does not include any costs for overhead, salaries, or any other internal expenses or profit incurred by the Taxpayer.

9. The Taxpayer does not receive any payment or reimbursement from Caterpillar, under the Agreement or otherwise, for any of its overhead, costs, salaries, profit, or internal expenses.

10. The amounts received by the Taxpayer from Caterpillar are not payments for services performed in advertising Caterpillar products nor do they constitute reimbursements by Caterpillar for the internal costs incurred by the Taxpayer in connection with advertising Caterpillar products.

11. The Taxpayer is not, nor does it hold itself out to the public as, a public relations company, advertising agency, advertiser, or similar business, nor does it engage in the business activities associated with such enterprises.

12. The Taxpayer employs a public relations director whose duties include the promotion of products sold and serviced by the Taxpayer.

13. The Taxpayer sells and services Caterpillar, Bucyrna-Eric, Donahoe, Pioneer Engineering, Bomag, Allatt, Allied, Raymond, Liftall, Rome, Sullair, Dentz and Ballderson products.

14. The duties of the public relations director also include promoting the public image of the Taxpayer (as contrasted with products sold by it), writing and editing "Pacific Progress", a Taxpayer publication circulated to its customers and employees, planning promotions, sales contests, special events and sales meetings, collecting and analyzing market information, supervising building and ground maintenance to enhance appearance and working conditions, encouraging participation in community

activities, producing advertising layouts, taking photographs, writing editorials and copy for advertisements, and selecting appropriate media.

15. The Caterpillar related activities form only a small and relatively minor part of the duties of the public relations director.

16. The primary advertising agency used by the Taxpayer, Tomczak Advertising Agency ("Tomczak"), provides the media production and printing work for advertising Caterpillar's products.

17. Tomczak bills the Taxpayer for such work. The Taxpayer then records the bills, makes full payment, establishes a journal entry for reimbursement from Caterpillar of 50% of such amounts and receipts Caterpillar's payments as reimbursements of expenses.

18. The Taxpayer has consistently treated reimbursements from Caterpillar of third party advertising charges, such as Tomczak, as a receivable due to an advancement on account of Caterpillar's obligations to third parties, not as earned income.

19. During the calendar years 1974 through 1977, the Taxpayer recorded third party advertising expenses incurred or advanced with respect to Caterpillar's products in the amount of \$159,150.82.

20. During the calendar year 1974 through 1977, the Taxpayer paid its public relation director the total aggregate sum of \$58,110.00.

21. During the calendar years 1974 through 1977,

the Taxpayer did not include the amounts reimbursed to it by Caterpillar pursuant to the Agreement, \$79,565.14, in its taxable gross income for General Excise Tax purposes.

22. On or about July 30, 1979, the Taxpayer was assessed by the Director of Taxation additional general excise taxes of \$3,780.55 on \$79,565.14 as income received from Caterpillar.

23. On August 21, 1979, the Taxpayer filed a notice of appeal from such assessment to the Board of Review of the First Taxation District and paid the assessment of \$3,780.55 under appeal as required by Chapter 237, Hawaii Revised Statutes, as amended.

24. On January 24, 1980, the Board of Review of the First Taxation District, after hearing, found in favor of the Taxpayer in the amount of \$3,780.55.

25. The Department of Taxation filed its Notice of Appeal from the decision of the Board of Review to the Tax Appeal Court, State of Hawaii, on February 15, 1980.

The following Conclusions of Law, insofar as they may be considered Findings of Fact, are also found by this Court to be true in all respects.

From the foregoing Findings of Fact, the Court makes the following:

CONCLUSIONS OF LAW

1. Section 327-13(16), HRS, imposes the General Excise Tax upon gross receipts derived by a taxable service

entity engaged in business within the State of Hawaii. Section 237-20, HRS, however, excludes from the definition of gross receipts the reimbursement of certain costs or advancements:

The reimbursements 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.

2. If the Taxpayer received additional monetary consideration for advertising costs and services incurred under the Agreement, then such amounts would constitute gross income. If the Taxpayer, however, receives only a reimbursement of costs incurred or advanced, without any additional monetary consideration, then such reimbursement is exempt from general excise taxation under Section 237-20, HRS.

3. The amounts received by the Taxpayer from Caterpillar under the Agreement meet the requirements of Section 237-20, HRS. The Agreement between Caterpillar and the Taxpayer provides for the reimbursement of the Taxpayer by Caterpillar of 50% of third party costs actually incurred by the Taxpayer on behalf of Caterpillar. The Agreement between the parties does not provide for any additional monetary consideration of any nature whatsoever to the Taxpayer for costs incurred pursuant to its terms.

4. The Agreement contains the true intentions of the parties thereto, possesses substance, and does not

constitute a sham characterization of a fee for services as a "reimbursement" for tax-avoidance purposes.

5. The argument of the Department of Taxation that the Taxpayer is an independent contractor and, therefore, not an agent making advances on behalf of Caterpillar as required by Section 237-20, HRS, is without merit. Section 237-20, HRS, does not require by its express terms or legislative history that a true agency relationship exist between the parties to meet its requirements for exemption. In Re Aloha Motors, Inc., 56 Haw. 231 (1975).

6. The Department of Taxation's contention that the Taxpayer's accounting system treats moneys received from Caterpillar as income to the Taxpayer and not as reimbursements of costs or advances is devoid of evidentiary support.

7. The cases of In Re Taxes, Foodland Super Market, 51 Haw. 281 (1969), and Valdimir Ossipoff & Associates, Inc. v. Kondo, Tax Appeal No. 1450 (1974), do not support the proposition that the reimbursements received by the Taxpayer from Caterpillar are taxable under Chapter 237, HRS. The Court concludes that these cases are not apposite to the issues presented in this proceeding.

8. The reimbursements of costs and advances from Caterpillar to the Taxpayer under the Agreement are reimbursements of costs or advances made by the Taxpayer on behalf of Caterpillar within the purview of Section 237-20, HRS.

Judgment will be entered affirming the decision

of the Board of Review of the First Taxation District and in favor of the Taxpayer in the amount of \$3,780.55 together with costs and interest as allowed by law.

J U D G M E N T

WHEREFORE, IT IS ORDERED, ADJUDGED AND DECREED that judgment is entered for the Taxpayer Pacific Machinery, Inc., in the amount of \$3,780.55, together with interest and costs as provided by law.

DATED: Honolulu, Hawaii, August 1,
1980.

Yasutaka Tsubokawa



JUDGE OF THE ABOVE-ENTITLED COURT

APPROVED AS TO FORM:

ALLAN S. CHOCK
ALLAN S. CHOCK, ESQ.

ATTORNEY FOR DEPARTMENT
OF TAXATION

