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IN THE TAX APPEAL COURT OF THE STATE OF HAWAII

CHARLES PANKOW ASSOCIATES, a California corporation, Plaintiff, vs. GEORGE FREITAS, in his capacity as Director of Taxation, Defendant.	T.A. No. 1889 FINDINGS OF FACT AND CONCLUSIONS OF LAW

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This case came 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

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

Briefly, the Taxpayer is a California corporation duly licensed to do business in the State of Hawaii at all times relevant hereto. The Taxpayer is a subsidiary of Charles

Pankow, Inc., a California corporation, and is part of an affiliated group including Pankow Building Systems, Inc., Pankow Construction Company and C. P. Investments, Inc. of these three affiliated companies, only C. P. Investments is a domestic corporation incorporated in the State of Hawaii.

The Taxpayer is engaged in the general contracting business. All of its contracting activities are performed entirely and exclusively on projects located in the State of Hawaii. All of the Taxpayer's operating gross income, $28,849,608, is derived from sources entirely within this State. It derives no business income from any source other than this State. The Taxpayer has derived interest income from the Crocker National Bank in California but this income has been returned to the State of Hawaii in the general excise tax return filed for the herein period with the State of Hawaii. The Taxpayer maintains its own employees in this State including general construction workers and those with skilled trades recruited from the local labor market. The Taxpayer neither maintains nor keeps any of its equipment in any state other than the State of Hawaii. Necessary equipment is imported for use in this State from Equipco, a California affiliate. In all of the construction projects, the Taxpayer purchases substantially all of the required materials and structural supplies from sources located within this State.

Certain administrative and related functions are performed in the State of California such as the purchase of blanket and key man insurance coverage, financing arrangements, most of the necessary legal services, budgetary preparation, bid specifications and preparation of tax returns. The Taxpayer's board of directors perform their duties almost exclusively in the State of California.

For the fiscal year ending May 31, 1979, the Taxpayer has filed a consolidated corporate income tax return with the State of Hawaii. By its return, the Taxpayer has apportioned and allocated its income. The Director has disallowed the filing of the consolidated return and has recomputed the Taxpayer's tax liability based upon a separate accounting method.

The Taxpayer urges it has the right to elect to return its income to the State of Hawaii based upon an apportionment and allocation method and that in doing so, it relied upon the method prescribed in the Multistate Tax Compact.

The Director contends he has the discretion to require the Taxpayer to return its income to this State based upon a separate accounting method where the allocation and apportionment method does not clearly and accurately reflect the amount of adjusted gross or taxable income (HRS Section 235-5) or the apportionment and allocation do not fully reflect the Taxpayer's business activities in the State (HRS Section 235-21, UDITPA, and Section 255-1, Multistate Tax Compact). The Director also urges that the Taxpayer is not qualified to file a consolidated return as a result whereof the redetermination of the Taxpayer's income tax liability to this State based upon a separate return is entirely proper and valid.

<u>CONCLUSIONS OF LAW</u>

1. The Taxpayer is a foreign corporation and is taxable upon its income received or derived from property owned, trade or business carried on, and from any and every other source in the State. HRS Section 235-4(d).

2. Where a foreign corporation is a multistate taxpayer engaged in interstate business thereby deriving income from sources within and from sources without the State, the taxpayer may make its return of income to the State of Hawaii based upon an apportionment and allocation. HRS Section 235-5; 235-21 et seq; 255-1 (Multistate Tax Compact). Apportionment is the rule and any method other than apportionment is the exception. Donald M. Drake Co. v. Department of Revenue, 500 P.2d 1041 (Ore. 1972). The burden, accordingly, falls upon the Director where he seeks any method other than apportionment.

3. HRS Section 235-92(2) allows the filing of a consolidated return to a group of affiliated domestic corporations. Although the Taxpayer argues it did not file a consolidated return but that the return was merely an apportionment of its income, the Court finds that the return filed by the Taxpayer to be a consolidated corporate income tax return and that the Director properly disallowed the return because all of the members of the affiliated group are not domestic corporations.

4. Based upon an examination of the return filed, the Court finds that the Taxpayer has elected the method prescribed under the Uniform Distribution of Income for Tax Purposes Act (HRS Section 235-21) and not, as the Taxpayer contends, the Multistate Tax Compact. There is, however, no practical difference in results whether or not the allocation and apportionment is made under either Act.

5. The Court further concludes the requirement of a separate accounting in this case is entirely proper and valid.

By its apportionment and allocation, the Taxpayer would return to the State of Hawaii taxable income of $3,577,319 out of its total gross receipts of $28,849,668. All of the Taxpayer's business income has been derived from contracting activities performed wholly and entirely in this State. As redetermined and recomputed by the Director, utilization of a separate accounting method would cause the Taxpayer to return to the State of Hawaii taxable income of $6,090,363, or an additional amount of $2,045,560. By comparison, the Taxpayer would return to the State of Hawaii only 53.6% of its taxable income. In light of the fact that the Taxpayer's contracting activities have been performed entirely and exclusively in the State of Hawaii and all of its business income has thereby been generated from activities entirely within this State, the Taxpayer's return neither clearly and accurately reflects its taxable income nor does it fairly represent the extent of the Taxpayer's activities in this State. Clearly, in this case, the Taxpayer's income from all sources in this State is properly segregable from income, if any, derived from sources outside the State as a result whereof the total net income realized by the Taxpayer must be allocated entirely to sources within this State. See <u>Montana Department of Revenue v. American Smelting and Refining Company,</u> 567 P.2d 901 (Mont. 1977). In light thereof, the Court is of the opinion the Director has adequately met his burden of showing to the satisfaction of this Court that a separate accounting is entirely proper in the circumstances of this case.

6. The additional income taxes herein assessed are proper and valid assessments.

7. Judgment will be entered for the Director of Taxation. The sum of $138,647.99 heretofore paid shall be, and is hereby made, lawful government realizations.

Dated: Honolulu, Hawaii, ______________________.

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Judge of the above-entitled Court

APPROVED AS TO FORM:

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