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TAX APPEAL COURT  
STATE OF HAWAII  
JUL 7 9 56 AM '95  
RUPERT SMITH  
Hawaii

CASE NO. 2127

IN THE TAX APPEAL COURT OF THE STATE OF HAWAII

In the Matter of the Tax	)	CASE NO. 2127
Appeal	)	
	)	FINDINGS OF FACT AND
of	)	CONCLUSIONS OF LAW
	)	
TRADEWIND TOURS OF HAWAII,	)	
INC.	)	
_____	)	

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause came on for hearing on the merits, and the Court, having duly considered the evidence, the memoranda 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. Taxpayer Tradewind Tours of Hawaii, Inc., is a Hawaii corporation licensed to do business in the State.

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

BARBARA E. WRIGHT

Clerk

2. The Taxpayer returns its income to the State by appropriate corporate income and general excise tax returns. These returns have been filed with the Director of Taxation for the relevant period involved in these proceedings. The period in controversy involves additional assessments of general excise taxes for tax years 1977-1981.

3. During the period in controversy, the Taxpayer owned 100% of the stocks of the following subsidiary corporations:

Inter Island Travel Services, Ltd.

Group Travel Unlimited, Inc.

Hawaii Discount Tours, Inc.

Waikiki Tourist Sales, Inc.

International Travel Services, Inc.

Hawaii Unlimited, Ltd.

Tradewind Charters, Inc.

Venture Resources, Inc.

Tradewind Promotions, Inc.

Professional Travel Management, Inc.

4. Four of the subsidiaries, Inter Island Travel Service, Ltd.; Hawaii Discount Tours, Inc.; Waikiki Tourist Sales, Inc.; and Venture Resources, Inc., were merged with the Taxpayer parent corporation effective January 1, 1981.

5. During the period in controversy, the Taxpayer has filed consolidated corporate net income tax returns on behalf of itself and all of the subsidiaries.

6. The Taxpayer has been in the tour and travel business for more than 30 years. During the five years in question, the principal executive officer of the Taxpayer and the subsidiaries in question here was Robert McGregor, and the principal accounting officer and treasurer of all of the corporations was Richard Fuchigami. All accounting functions for the parent and all subsidiaries were handled from the same desks of Mr. Fuchigami and his assistants. All other management functions were determined by Mr. McGregor and his assistants.

7. The Taxpayer has furnished and performed administrative and management services and functions to certain of its subsidiaries, including accounting and record keeping, the type of accounts to be kept as well as the manner by which the transactions were to be recorded and posted.

8. The Taxpayer never performed any management, accounting or similar services for any corporation other than its wholly owned subsidiaries.

9. The Taxpayer made all decisions with respect to the type and amount of expenses to be incurred without consultation of the subsidiaries.

10. Until 1977, the Taxpayer operated as a single entity with several unincorporated divisions or departments. During the entire period, for the purpose of providing management with comparative data on how each department was performing, the accounting people in coordination with

Mr. McGregor, annually made allocations of overhead expenses among the departments.

11. In 1976, following a consent decree to an antitrust action in the federal court, the attorneys for the Taxpayer recommended that the Taxpayer incorporate the several departments. The Taxpayer did so.

12. During the years 1977-1981, the Taxpayer continued its prior practice of overhead allocation statistics, but instead of departments, the divisions were wholly owned subsidiary corporations. No bills were sent to the subsidiaries.

13. In furnishing and performing management and administrative services and functions, the Taxpayer incurred certain overhead and administrative expenses including salaries and wages, payroll expenses, employee benefits, advertising and promotion, auditing fees, legal fees, insurance, sales and executive expenses and others. These services are further detailed in Director's Exhibit IV.

14. There was no express agreement between the Taxpayer and the subsidiaries for the repayment or reimbursement of the expenses.

15. For tax years 1977 and 1978, the Taxpayer has reported unrecorded management fees as "Other Income" in its consolidated corporate net income tax returns.

16. For tax years 1979 to 1981, an allocation of these expenses were made under the heading of "Overhead

Expenses Allocated" and the allocations were reported in the respective consolidated corporate net income tax returns under the items: overhead expense allocated, administrative, stock control or accounting and administrative expenses.

17. The overhead expenses allocated account has been credited in the amount the respective subsidiaries have been charged as expenses for the services rendered.

18. The Taxpayer has elected to report its income on an accrual basis of accounting rather than on a cash basis, accordingly, income is recorded when the management and administrative services and functions have been performed.

19. No cash payments were transferred between the Taxpayer and the subsidiaries for whom the services and functions were furnished.

20. Some of the affected subsidiaries also do business in a few other states. For these subsidiaries, the allocated expenses were reported in the returns filed in the other states in order to arrive at their appropriate taxable income.

21. The tax case arose by a notice of assessment from the Department of Taxation to the Taxpayer, Tradewind Tours of Hawaii, Inc., dated November 11, 1983, assessing additional general excise taxes and interest as follows:

<u>Year</u>	<u>Tax</u>	<u>Interest</u>	<u>Total</u>
1977	\$11,611.08	\$ 5,108.88	\$16,719.96
1978	12,908.44	5,647.40	17,556.84
1979	18,437.52	5,162.51	23,600.03
1980	24,630.72	4,926.14	29,556.86
1981	<u>8,280.58</u>	<u>993.67</u>	<u>9,274.25</u>
	\$75,869.34	\$20,838,60	\$96,707.94

The only explanations set forth in the Director's notices of assessment were for years 1977 and 1978:

Management fees to subsidiaries are subject to General Excise Tax.

and for years 1979, 1981, and 1981:

Allocation of overhead costs to subsidiaries is subject to the General Excise Tax.

22. The Notices of Assessment of Additional General Excise Taxes were sent to the Taxpayer on November 10, 1983.

23. Testimony from both the Taxpayer's and the Director's witnesses establish that active discussions were had between the Taxpayer's representatives and the audit staff of the Department of Taxation.

#### CONCLUSIONS OF LAW

1. The controlling principles in these proceedings are set forth in the appeal of In Re C. Brewer and Company, Limited, 65 Haw. 240 (1982) and are amply discussed therein. In that case, the Court affirmed the assessment made by the Director of Taxation for management and administrative services and functions furnished by Brewer to its wholly owned subsidiaries.

The Court found, as a basis for excise taxation, that HRS Chapter 237 imposes an excise tax upon the privilege of engaging in business in the State. Section 237-13(10) evidences in plain and unmistakable language the legislative intention to tax every form of business subject to the taxing jurisdiction and not specifically exempted from its provisions. In Re Grayco Land Escrow, Ltd., 57 Haw. 436 (1977). In enacting the general excise tax, the legislature cast a wide and tight net so that the tax is imposed upon all entrepreneurs and at all levels of economic activity. Pratt v. Kondo, 53 Haw. 435 (1972). Moreover, a parent corporation may be taxed upon its business with a subsidiary. HRS Section 237-20; In Re Tax Appeal of Island Holidays, Inc., 59 Haw. 307 (1978), reh. den. 59 Haw. 408, 667 (1978).

2. More specifically, with respect to the taxability of parent-subsidiary or inter-company transactions, the Court determined the following legal principles:

(a) A parent corporation which furnishes and performs managerial and administrative services and functions to a subsidiary, whether wholly owned or not, is engaged in business within the purview of HRS Chapter 237, the Hawaii General Excise Tax Law.

(b) Where the parent and subsidiaries are organized for business purposes, the expenses and disbursements are incurred for the economic benefit of both parent and the subsidiaries and thereby satisfies the prerequisites for

"business" or "engaging in business" prescribed in HRS Section 237-2.

(c) Actual payment of money or its equivalent are not prerequisites for general excise taxation.

(d) Under HRS Section 237-3, gross income or gross receipts for general excise taxation is satisfied where there is value accruing or proceeding from the activity.

(e) The parent acquires enforceable rights by providing services to the subsidiaries. Whether or not the obligations are satisfied or not through actual payment are of no consequence where there is value proceeding from the services.

(f) The Taxpayer may arrange his business affairs in any manner he desires within permissible proscriptions of the law but the Director is not bound by the accounting practices of the Taxpayer. The Director can look at the substance rather than the form of the transaction in fixing tax liability. Actualities and consequences of a commercial transaction, rather than the method employed in doing business, are controlling factors in fixing tax liability.

(g) Private agreements are not binding upon the Director of Taxation.

4. The Court concludes as a matter of law that the administrative and management services and functions were furnished and performed in the ordinary course of the Taxpayer's business, accordingly, the expenses and



disbursements were incurred for the economic benefit of both the parent and its subsidiaries.

5. Although the Taxpayer chose to record the transactions so as not to reflect income, nonetheless, gross income or gross receipts for general excise tax purposes is satisfied where there is value accruing or proceeding from the services or functions furnished and performed. No cash or actual payment is required. In this case the Taxpayer has acquired enforceable rights by providing services to its subsidiaries. By its exercise of direct control over the subsidiaries, e.g., right to declare dividends, return of capital, sale of a subsidiary, economics of scale in its operations, relieving the subsidiaries from incurring these expenses, also results in values inuring to the taxpayer and its subsidiaries. It has also reduced the amount of these services to a monetary value and has reflected these amounts as income for net income taxation. The fact that, by a consolidation of its income and expenses, no taxable income results for net income tax purposes is of no consequence. Consolidation of returns is not allowed for general excise taxation. There is, therefore, value proceeding from the services rendered.

6. The Taxpayer has reported these transactions as items of income for purposes of federal and state corporate income tax laws. In order to properly reflect the income

reported by the Taxpayer, when the services were furnished and performed and the expenses incurred, appropriate entries should have been recorded showing a credit to expenses and a debit entry to receivables. The books of the subsidiaries should reflect appropriate entries debiting expenses and crediting their payable accounts. Upon payment, an appropriate debit entry should be made to cash and an off-setting entry to receivables. Likewise, for the subsidiaries, upon payment, the payables should be debited and an off-setting credit entry made to cash. The Taxpayer must treat transactions uniformly for all purposes within the tax scheme and he may not show one scheme for federal tax purposes and a non-taxable scheme for purposes of the State general excise tax law. Co-Con, Inc. v. Bureau of Revenue, 529 P.2d 1239 (N.M. 1977); Stohr v. New Mexico Bureau of Revenue, 559 P.2d 420 (N.M. 1977).

The Director may look at the substance of a transaction rather than its form. In Re Ulupalakua Ranch, Inc., 52 Haw. 557 (1971). Moreover, actualities and consequences of a commercial transaction rather than the method employed in doing business are controlling in determining tax liability. In Re Kobayashi, 441 Haw. 584 (1961).

The Taxpayer has treated the allocations of expenses on its tax returns as evidenced by reporting "unrecorded management fees" for tax years 1977 and 1978, and by reducing the overhead expenses allocated to the parent for tax years 1979-81 by the exact amount of overhead, stock control and

administrative expenses listed for the subsidiaries. Although these schedules had no effect on taxable income on the consolidated basis for net income taxation purposes, these entries evidence an allocation of the costs incurred in furnishing and performing administrative and management services, expenses and functions.

7. The Taxpayer's witnesses testified the entries reflecting the allocation of expenses were reversed at the end of each year, in support of the Taxpayer's contention that the Taxpayer never intended to charge its subsidiaries; accordingly, no income was derived from the Taxpayers' activities whether or not the Taxpayer reports its income upon an accrual or cash basis.

The Court finds this contention to be without merit. The dollar and cents value of these services and functions have been reported in the returns; the Taxpayer's own witness has testified that the expenses charged to the subsidiaries for these services and functions have been reported in returns filed in a few other states to determine their tax liability. If the entries had been reversed at the end of each year, no reportable credits or debits would be shown.

8. The Taxpayer argues strenuously that no income was realized and cites various authorities in support thereof. The arguments and the authorities cited, however, are inapposite hereto for the reason they are based upon principles

involving net income taxation. Although the Internal Revenue Code has been incorporated into the net income tax law by HRS Chapter 235, the provisions of the Code are not made directly applicable in the determination of gross income for general excise tax purposes. In Re Island Holidays, Inc., supra.

9. The Court concludes the Taxpayer has failed to meet its burden of proving that the assessments are incorrect. HRS Section 231-20 provides that assessments made by the Director of Taxation shall be deemed to be prima facie correct. The presumption must be overcome by the Taxpayer by clear and competent evidence. This the Taxpayer has failed to do.

10. The Taxpayer contends the assessments made by the Director of Taxation to be invalid because they violated the provisions of HRS Section 91-12 of the Hawaii Administrative Procedures Act. The contention is made solely upon the assertion that the Director did not make written findings of fact and conclusions of law in connection with the assessment. The Court finds the contention to be without merit.

IT IS ACCORDINGLY ADJUDGED, ORDERED AND DECREED that the Director of Taxation properly assessed additional general excise taxes herein and the said taxes have been properly

imposed at the four per cent rate. The additional taxes herein paid are properly deemed government realizations.

DATED: Honolulu, Hawaii, JUN 07 1985.

FRANK T. TAKAO  
JUDGE OF THE ABOVE-ENTITLED COURT

NOT APPROVED AS TO FORM:

Arthur B. Reinwald

ARTHUR B. REINWALD  
Attorney for Taxpayer

See objections filed herewith