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This Week in State Tax (TWIST)

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Hawaii: State Supreme Court holds taxpayer may seek declaratory relief from state tax regulation

The Supreme Court of Hawaii recently resolved a procedural question of whether a taxpayer may challenge the facial validity of a tax administrative rule through the state's declaratory relief statute for agency rules, rather than being forced to wait for an assessment and litigate through the tax appeal process. The Court concluded that the taxpayer has standing as an "interested person" to seek a judicial declaration on the validity of an agency rule, notwithstanding a separate statute that bars declaratory relief in "any controversy with respect to taxes." In reaching this result, the Court overruled its earlier decision in *Hawaii Home Infusion Associates v. Befitel*, rejected the state's mootness argument, and remanded the case for further proceedings.

The dispute arose from a rule promulgated by the Department of Taxation in 2018 which addressed when certain agent services are used or consumed in Hawaii for General Excise Tax (GET) purposes. Under the rule, income is sourced to where a transient accommodation or travel-related booking is located rather than where a booking agent is situated when making the reservation. As a result, the taxpayer, an online travel and accommodation reservation platform, became subject to Hawaii’s GET on the commissions it earned on Hawaii bookings.

In 2019, before any tax was assessed, the taxpayer filed suit in state circuit court under a statute allowing an “interested person” to pursue a declaratory action, seeking a declaration that the services sourcing rule was invalid under the federal Internet Tax Freedom Act and the Commerce and Supremacy Clauses of the U.S. Constitution. While the suit was pending, the Department of Taxation assessed the taxpayer substantial tax, penalty and interest for the period 2010 through 2020. The taxpayer separately appealed that assessment to the tax appeal court.

The Department of Taxation moved to dismiss the declaratory action, arguing that the pending assessment appeal rendered the case a "controversy with respect to taxes," which state law prevents from being subject to a declaratory action. The circuit court agreed and dismissed the taxpayer’s declaratory action, reasoning that the sourcing rule could instead be tested through the tax appeal. The Intermediate Court of Appeals affirmed, holding that the taxpayer lacked standing and that declaratory relief was unavailable because the matter involved taxes. The taxpayer then appealed to the Hawaii Supreme Court.

The Supreme Court agreed with the taxpayer and vacated the lower courts’ decisions. The Court held that the interested person statute used by the taxpayer and the statute barring declaratory relief for tax controversies are separate and independent statutes. Central to the Court's reasoning was that the interested person statute contains no language excluding tax rules from its reach, so nothing prevents a taxpayer from using it to challenge

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a tax regulation on its face.

The Court also resolved several related issues. It overruled *Hawaii Home Infusion Associates*, holding that the interested person statute provision directing the action be filed where the petitioner resides or has its principal place of business addresses venue, rather than being a limitation on the court's subject matter jurisdiction. Therefore, it was appropriate for the action to be filed where the agency promulgating the rule was located, as was the case here. The Court further held that the case was not moot even though the tax appeal court had already invalidated the service sourcing rule, because the issue of whether declaratory relief is available for tax rules remained unresolved and was too important to leave unaddressed. Finally, the Court held that the taxpayer qualified as an "interested person" with standing, reversing the Intermediate Court of Appeals.

Please contact Reid Okimoto and Jacob Herlitz with questions regarding *Booking.com B.V. v. Suganuma*.