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## A BILL FOR AN ACT

RELATING TO LEASEHOLD CONVERSION.

**BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:**

1           SECTION 1. The legislature finds that in 1967, in response  
2 to ideological forces fighting an oligopolistic land tenure  
3 system in Hawaii and spurred on by more practical reasons of  
4 increasing lease rents on renegotiations, the legislature  
5 enacted Act 307, Session Laws of Hawaii 1967 (Act 307), codified  
6 as chapter 516, Hawaii Revised Statutes (chapter 516).

7           Chapter 516 allows lessees of long-term leasehold interests  
8 in single-family residential development tracts to purchase the  
9 fee interest of their residential lots through a condemnation  
10 process involving the fee simple landowner and what is now the  
11 Hawaii housing finance and development corporation. The latter  
12 party would condemn the fee interest, paying the fee owner fair  
13 compensation for the fee interest and, in turn, sell the  
14 acquired fee interest to the leasehold homeowner. In 1984,  
15 following extended litigation, the United States Supreme Court  
16 ruled in *Hawaii Housing Authority v. Midkiff*, that Act 307 did  
17 not violate the United States Constitution. Shortly thereafter,  
18 in *Hawaii Housing Authority v. Lyman*, the supreme court of Hawaii



1 also found that Act 307 did not violate the state constitution.  
2 As a result, over the last twenty-five years, the number of  
3 leasehold single-family residences fell from a high of  
4 approximately twenty-eight thousand to four thousand six  
5 hundred.

6 The legislature also finds that following the successful  
7 effort to substantially reduce the size of the leasehold system  
8 in Hawaii as applied to single-family dwellings, many owners of  
9 multi-family residential leasehold units facing lease rent  
10 renegotiations, including cooperative housing corporations,  
11 condominiums, and planned development housing, aspired to  
12 purchase the fee interests under their multi-family units. Over  
13 the years, numerous bills were introduced to extend the right to  
14 purchase the fee interest to a multi-family unit leasehold  
15 owner, culminating in 1991 with two bills introduced in the  
16 legislature proposing mandatory leasehold conversion for multi-  
17 family units or, in the alternative, giving the lessor the  
18 option of leasehold conversion or lease rent control. Neither  
19 bill passed the legislature.

20 However, in 1991, the Honolulu city council adopted  
21 ordinance 91-95, which granted multi-family residential  
22 leaseholders the right to purchase the fee simple interest to



1 their units in a condemnation procedure similar to chapter 516.  
2 The new ordinance, codified at chapter 38, Revised Ordinances of  
3 Honolulu (chapter 38); provided that at least twenty-five of all  
4 the condominium owners (defined as owner-occupants) or owners of  
5 a certain percentage of the condominium units within the  
6 development, whichever was less, could trigger the condemnation  
7 process by the city department of housing and community  
8 development.

9       Following the inevitable court challenge in *Richardson v.*  
10 *City and County of Honolulu*, the United States Ninth Circuit  
11 Court of Appeals held that the ordinance did not violate the  
12 United States Constitution. In 2002, in *Coon v. City and County*  
13 *of Honolulu*, the Hawaii supreme court upheld the validity of  
14 chapter 38. However, the court also held that the rules adopted  
15 to implement chapter 38, relating to determining the minimum  
16 number of applicants required to initiate the conversion  
17 process, violated the ordinance by impermissibly lowering the  
18 minimum number of applicants required.

19       This holding prompted the Honolulu city council to attempt  
20 to amend chapter 38 in 2002 by introducing Bill 53, which would  
21 have brought chapter 38 in line with the liberal rules for  
22 triggering the conversion process, consequently making it as



1 broadly applicable as possible. However, this time the  
2 proponents were met by a more organized effort by fee owner  
3 lessors seeking to keep the conversion process comparatively  
4 narrow by excluding as many multi-family projects as possible  
5 from the process established in chapter 38.

6 In response to this opposition, the Honolulu city council  
7 tabled the measure.

8 In January 2005, after decades of heated debate between  
9 proponents and opponents of mandatory residential leasehold  
10 conversion, the Honolulu city council repealed chapter 38,  
11 thereby repealing the city and county's authority to mandate the  
12 leasehold conversion of multi-family residential leasehold  
13 units.

14 The legislature believes that, rather than perpetuate a  
15 process that polarizes members of the community, an incentive-  
16 based approach to the issue should be pursued. To this end, the  
17 legislature believes that providing fee owners of multi-family  
18 residential leasehold property with the opportunity, for a  
19 limited time, to exclude from their taxable income one hundred  
20 per cent of the capital gains realized from the sale of the  
21 leased fee interest to the lessee, but not to exceed \$800,000 of  
22 exclusion in the aggregate for all taxpayers in any tax year,



1 would provide fee owners with the proper incentive to sell the  
2 fee interests in their real property.

3 The purpose of this Act is to allow, for a limited time, a  
4 fee owner to exclude from taxable income one hundred per cent of  
5 the gain realized from:

6 (1) The sale of the leased fee interest in a residential  
7 house lot or multi-family residential leasehold unit  
8 to the lessee of the house lot or unit; or

9 (2) The sale of the leased fee interest in a multi-family  
10 residential leasehold property to the association of  
11 apartment owners or the residential cooperative  
12 corporation of the multi-family residential leasehold  
13 property.

14 SECTION 2. Section 235-7, Hawaii Revised Statutes, is  
15 amended by amending subsection (a) to read as follows:

16 "(a) There shall be excluded from gross income, adjusted  
17 gross income, and taxable income:

18 (1) Income not subject to taxation by the State under the  
19 Constitution and laws of the United States;

20 (2) Rights, benefits, and other income exempted from  
21 taxation by section 88-91, having to do with the state  
22 retirement system, and the rights, benefits, and other



- 1 income, comparable to the rights, benefits, and other  
2 income exempted by section 88-91, under any other  
3 public retirement system;
- 4 (3) Any compensation received in the form of a pension for  
5 past services;
- 6 (4) Compensation paid to a patient affected with Hansen's  
7 disease employed by the State or the United States in  
8 any hospital, settlement, or place for the treatment  
9 of Hansen's disease;
- 10 (5) Except as otherwise expressly provided, payments made  
11 by the United States or this State, under an act of  
12 Congress or a law of this State, which by express  
13 provision or administrative regulation or  
14 interpretation are exempt from both the normal and  
15 surtaxes of the United States, even though not so  
16 exempted by the Internal Revenue Code itself;
- 17 (6) Any income expressly exempted or excluded from the  
18 measure of the tax imposed by this chapter by any  
19 other law of the State, it being the intent of this  
20 chapter not to repeal or supersede any such express  
21 exemption or exclusion;



1           (7) Income received by each member of the reserve  
2           components of the Army, Navy, Air Force, Marine Corps,  
3           or Coast Guard of the United States of America, and  
4           the Hawaii national guard as compensation for  
5           performance of duty, equivalent to pay received for  
6           forty-eight drills (equivalent of twelve weekends) and  
7           fifteen days of annual duty, at an:  
8           (A) E-1 pay grade after eight years of service;  
9           provided that this subparagraph shall apply to  
10          taxable years beginning after December 31, 2004;  
11          (B) E-2 pay grade after eight years of service;  
12          provided that this subparagraph shall apply to  
13          taxable years beginning after December 31, 2005;  
14          (C) E-3 pay grade after eight years of service;  
15          provided that this subparagraph shall apply to  
16          taxable years beginning after December 31, 2006;  
17          (D) E-4 pay grade after eight years of service;  
18          provided that this subparagraph shall apply to  
19          taxable years beginning after December 31, 2007;  
20          and



- 1 (E) E-5 pay grade after eight years of service;
- 2 provided that this subparagraph shall apply to
- 3 taxable years beginning after December 31, 2008;
- 4 (8) Income derived from the operation of ships or aircraft
- 5 if the income is exempt under the Internal Revenue
- 6 Code pursuant to the provisions of an income tax
- 7 treaty or agreement entered into by and between the
- 8 United States and a foreign country[~~r~~]; provided that
- 9 the tax laws of the local governments of that country
- 10 reciprocally exempt from the application of all of
- 11 their net income taxes, the income derived from the
- 12 operation of ships or aircraft that are documented or
- 13 registered under the laws of the United States;
- 14 (9) The value of legal services provided by a prepaid
- 15 legal service plan to a taxpayer, the taxpayer's
- 16 spouse, and the taxpayer's dependents;
- 17 (10) Amounts paid, directly or indirectly, by a prepaid
- 18 legal service plan to a taxpayer as payment or
- 19 reimbursement for the provision of legal services to
- 20 the taxpayer, the taxpayer's spouse, and the
- 21 taxpayer's dependents;



- 1       (11) Contributions by an employer to a prepaid legal
- 2           service plan for compensation (through insurance or
- 3           otherwise) to the employer's employees for the costs
- 4           of legal services incurred by the employer's
- 5           employees, their spouses, and their dependents; [~~and~~]
- 6       (12) Amounts received in the form of a monthly surcharge by
- 7           a utility acting on behalf of an affected utility
- 8           under section 269-16.3 shall not be gross income,
- 9           adjusted gross income, or taxable income for the
- 10          acting utility under this chapter. Any amounts
- 11          retained by the acting utility for collection or other
- 12          costs shall not be included in this exemption[-]; and
- 13       (13) Until January 1, 2010, one hundred per cent of the
- 14       gain realized by a fee simple owner:
- 15           (A) From the sale of a leased fee interest in a
- 16           residential house lot to the lessee of the
- 17           residential house lot;
- 18           (B) From the sale of a leased fee interest in a
- 19           multi-family residential leasehold unit to the
- 20           lessee of a multi-family residential leasehold
- 21           unit; or



1           (C) From the sale of a leased fee interest in a  
2           multi-family residential leasehold property to  
3           the association of apartment owners or the  
4           residential cooperative corporation of the multi-  
5           family residential leasehold property; provided  
6           that:  
7           (i) The term "fee simple owner" shall include  
8           legal and equitable owners;  
9           (ii) The terms "fee simple owner", "legal and  
10           equitable owner", "leased fee interest", and  
11           "lessee" shall have the meanings established  
12           in section 516-1;  
13           (iii) The terms "multi-family residential  
14           leasehold property" and "multi-family  
15           residential leasehold unit" shall mean a  
16           property or unit within a planned unit  
17           development, which shall have the same  
18           meaning as "planned community" as defined in  
19           section 421J-2, or within a "condominium  
20           project" or "cooperative project", as the  
21           latter terms are defined in section 514C-1;  
22           and



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1                    (iv) The exclusion shall not exceed \$800,000 in  
 2                    the aggregate for all taxpayers in the State  
 3                    in any tax year."

4            SECTION 3. Statutory material to be repealed is bracketed  
 5 and stricken. New statutory material is underscored.

6            SECTION 4. This Act shall take effect on July 1, 2007, and  
 7 shall apply to taxable years beginning after December 31, 2007,  
 8 and ending prior to January 1, 2010.

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**Report Title:**

Leased Fee Interest Sale; Capital Gains Exemption

**Description:**

Until 1/1/10, excludes from income taxation 100% of capital gains realized from the sale of leased fee interest in residential house lot or multi-family residential leasehold property to a lessee, association of apartment owners, or cooperative, subject to an aggregate cap of \$800,000 per year.

