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**HOUSE COMMITTEE ON FINANCE  
TESTIMONY REGARDING HB 1921 HD 1  
RELATING TO CONTROLLING INTEREST TRANSFER TAX**

**TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)**

**DATE: FEBRUARY 25, 2010**

**TIME: 10AM**

**ROOM: 308**

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This measure proposes a new real property asset conveyance tax to capture the tax on the sale of stock in entities that own Hawaii real property. As amended, this measure matches the tax rate of the new proposed controlling interest transfer tax to that of the conveyance tax.

The Department of Taxation (Department) **supports the intent of capturing the tax lost due to complex tax advantaged deal structuring**; however **prefers a simpler method**.

**SUPPORT FOR MINIMIZING THE TAX LOSS FROM STRUCTURING**—The intent of this legislation appears to close the "loophole" that is perceived in the taxation of real property transfers where the stock in the entity that owns the property is sold and not the property itself. Though there is nothing inherently wrong with this structuring, it can result in the loss of tax revenue, specifically conveyance tax. The Department supports legislation to capture the proper amount of tax that, in reality and looking through structuring, should be paid for the sale of real property.

**SIMPLY MODIFY CURRENT CONVEYANCE TAX**—The Department suggests that, rather than an entirely new tax chapter, simply make an amendment to the conveyance tax chapter to "look through" structuring of real property sales through entity equity transactions.

Another alternative could be to assess a personal property tax on the stock transfer of entities that own real property equal to the foregone real property tax. There are several ways to close this gap, which the Department suggests be focused in the conveyance tax law rather than a new chapter.

By modifying the current conveyance tax, the entire tax regime will be applied to the stock sales, including procedural matters, exemptions, and enforcement.

**MODIFY THE CONVEYANCE TAX TO SAVE TIME AND MONEY IN IMPLEMENTATION**—The Department requests that the controlling interest transfer tax be integrated into the conveyance tax in order to efficiently begin implementation of this tax. If the proposed transfer tax is a new tax type, it will cost the Department time and unbudgeted moneys for new forms and computer enhancements. If it is simply a conveyance tax addition, the existing forms and computer programming can be modified much easier without the added delay or expense of a new tax type. The Department strongly urges the Committee to modify this measure to be an addition to the conveyance tax, especially since the effective date begins January 1, 2010. In its current form, the Department would need considerable time to carryout implementation tasks that will be prioritized with other measures that are passed this session, which as a new tax type could take several weeks or months.

**REVENUE IMPACT**—This legislation could result in revenue gains as follows:

- General Fund Revenues: \$1.1 million in FY 2011 and 2012. \$0.8 million in FY 2013 and thereafter;
- Special Fund Revenues: \$1.3 million in FY 2011 and 2012. \$1.6 million in FY 2013 and thereafter.

**ASSISTANCE**—The Department will make itself available to assist the Committee in drafting language that could close the loophole this measure seeks to close.

# TAXBILLSERVICE

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SUBJECT: CONVEYANCE, MISCELLANEOUS, Controlling interest transfer tax

BILL NUMBER: HB 1921, HD-1

INTRODUCED BY: House Committee on Economic Revitalization, Business and Military Affairs

**BRIEF SUMMARY:** Adds a new chapter to HRS to provide for the imposition of a controlling interest transfer tax imposed at the rates established under the conveyance tax under HRS section 247-2. The tax shall be imposed on transfers of real property when the present true and actual value of the interest in real property equals or exceeds \$2,000 and when: (1) the transfer of a controlling interest is made by a seller or transferor or by a group of sellers or transferors acting in concert; provided that sellers or transferors who are related to each other by blood or marriage are presumed, unless shown to the contrary, to be acting in concert; (2) the controlling interest in an entity transfers real property to a transferee or to a group of transferees acting in concert; provided that: (a) where transferees are related and one influences or controls the actions of another (such as parent and subsidiary corporations, parents and children, husbands and wives, etc.), the transferees shall be presumed to be acting in concert; and (b) where transferees have negotiated and will consummate their purchase of ownership interests in unity (such as transfers that are closely related in time, transferees that are few in number, or purchase contracts that contain mutual terms, and agreements among transferees binding them to a course of action with respect to the transfers, etc.), the transferees shall be presumed to be acting in concert.

The tax shall be imposed on the present true and actual value of the interest in real property transferred at the rate set forth in section 247-2. The tax shall be payable by the entity or entities selling or transferring the controlling interest, or as designated by the director pursuant to rule. If the entity owns less than 100% interest in the real estate, the tax shall be based on the actual percentage of ownership with no further discounts on account of minority ownership.

A taxable sale or transfer of a controlling interest may occur in one transaction or in a series of transactions; provided that transactions that occur within six months of each other are presumed to be a series of transactions.

Stipulates that the controlling interest transfer tax shall not be applicable to: (1) any sale or transfer of a controlling interest in any entity to the extent that the entity possesses, directly or indirectly, an interest in real property located in an area of any county designated as an enterprise zone; or (2) any sale or transfer of a controlling interest in any entity to effectuate a change of identity or form of ownership or organization where there is no change in beneficial ownership.

Makes conforming amendments to HRS chapter 247.

**EFFECTIVE DATE:** Tax years beginning after December 31, 2009

STAFF COMMENTS: The proposed measure would create a new tax subject to the conveyance tax rates to ensure that "complex transactions" involving the transfer of real property in the state are taxed, even though they are not currently taxable under the conveyance tax as the real property is owned by a legal entity like a corporation or partnership. While it is the intent of the measure to close this loophole as the measure argues that these transfers attempt to evade taxation, it should be noted that the current conveyance tax was never established to be a source of revenue. Only in recent years as lawmakers sought to fund their favorite programs did the conveyance tax come under fire as a way to raise new sources of revenue to fund favored programs. With rates as high as \$1.25 per hundred dollars of value transferred, lawmakers now believe that transfers of real property, albeit as part of the acquisition of a company or partnership, are an intentional evasion of the tax. Thus, it is not hard to believe that the proposed modest rate will mushroom in a few years as the imposition of this new tax will be viewed as another way to raise additional revenue.

Unfortunately, this new tax will add another nail in the economic coffin of Hawaii as it is just one more cost that an investor must weigh in deciding whether or not the return on an investment in Hawaii is attractive or reasonable.

It should be remembered that the conveyance tax was initially enacted by the 1966 legislature after the repeal of the federal law requiring stamps for transfers of real property. It was enacted for the sole purpose of providing the department of taxation with additional data for the determination of market value of properties transferred. This information was also to assist the department in establishing real property assessed values and at that time the department stated that the conveyance tax was not intended to be a revenue raising device. The conveyance tax is imposed each time property changes title or ownership. However, over the years the tax has been increased and conveyance tax revenues have been tapped to provide revenue for the land conservation fund, rental housing trust fund, and the natural area reserve fund. If the proposed controlling interest transfer tax becomes enacted, there may be temptation to extract additional revenue from the new tax by increasing the tax rate in subsequent years. Once a tax has become planted and begins to sprout new tax revenue, such a tax will be difficult to repeal or eliminate.

While this proposal tries to address what looks like a sale of an entity or organization that has as part of its portfolio real property in Hawaii, there are other ways of transferring a company and the controlling interest of such an entity can be effected without the appearance that the organization or entity is being sold or transferred.

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**Testimony to the House Committee on Finance**

**Thursday, February 25, 2010**

**10:00 a.m.**

**Conference Room 308**

**Agenda #1**

**RE: HOUSE BILL 1921 HD1 RELATING TO A CONTROLLING INTEREST  
TRANSFER TAX**

Chair Oshiro, Vice Chair Lee and Members of the Committee:

My name is Jim Tollefson and I am the President and CEO of The Chamber of Commerce of Hawaii ("The Chamber"). The Chamber understands the need to review all options in addressing the budgetary issue, however, at this time, we oppose HB 1921 HD1.

The Chamber is the largest business organization in Hawaii, representing more than 1,000 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of its members, which employ more than 200,000 individuals, to improve the state's economic climate and to foster positive action on issues of common concern.

The Chamber does not support this measure based on the following:

1. The bill is unclear as to what is subject to the tax, who is liable for the tax, and what the amount of the tax is. First, the bill would tax transfers of interests in entities that own real property either "directly or indirectly," but leaves the meaning of this phrase to the imagination. Second, the bill does not clearly state whether it is the selling shareholder or the entity itself that must pay the tax. Third, the bill does not specify whether the tax is imposed on (a) the total consideration paid for the interest in the entity; (b) the value of the Hawaii real property held by the entity; or (c) the value of all real property held by the entity. These ambiguities would create an enormous amount of uncertainty for taxpayers in our state.
2. The bill would be extremely difficult for both the state and taxpayers to administer. Assuming the bill would impose tax on the value of the underlying real property held by

the entity (which, as indicated above, is not at all clear), it provides no guidance as to how to calculate that value. In the case of conveyance taxes, the taxable value is relatively clear -- it is generally the purchase price of the property. When an interest in an entity is sold, however, the value of any one particular property held by that entity may be extremely speculative. The entity may have numerous assets, and neither the taxpayers nor the government will have any clear idea of what any one particular property is worth. The bill would thus force either an appraisal of the underlying real property (which would impose serious additional expense and delay on the transaction), or would invite the taxpayers or the government to merely guess at the property value.

3. Although the bill targets conveyance tax avoidance, it is so broadly drafted that it would tax all sorts of transactions where a conveyance tax is already being paid. This would in effect create a "double conveyance tax" on bona fide business transactions, further discouraging investment in our state.

Thank you very much for the opportunity to submit testimony.