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To: The Honorable Donovan M. Dela Cruz, Chair
and Members of the Senate Committee on Ways and Means

Date: Monday, January 29, 2018
Time: 10:15 A.M.
Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 2506, Relating to Taxation

The Department of Taxation (Department) provides the following comments regarding S.B 2506 for your consideration. S.B. 2506 increases the amount that must be withheld on the disposition of Hawaii real property by a nonresident from 5% to 9% of the gross sales proceeds. The measure is effective upon approval and applies to taxable years beginning after December 31, 2017.

First, the Department suggests clarifying the applicability of this measure. Applying the measure to a tax year instead of a specific date may cause ambiguity. In addition, the current effective date would apply retroactively for all calendar year taxpayers. The Department suggests that the measure be amended to apply to disposition of Hawaii real property that occur after a specific date. Since the Governor’s veto deadline is in July the Department suggests a date in September or later to allow escrow and all other interested parties to become informed of the change.

Second, the Department notes that the proposed withholding rate may be excessive, since the amount is based on the gross proceeds of sale without deduction for closing costs, costs of sale, or the cost basis of the property. Most real property sales will qualify for capital gains treatment, which has a maximum rate of 7.25% of the net gain, determined after all allowable costs and reduced by the adjusted tax basis of the property.

Finally, the Department is able to implement the proposed amendments in this measure. Thank you for the opportunity to provide comments.

LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Increase HARPTA Withholding to 9%

BILL NUMBER: SB 2506

INTRODUCED BY: DELA CRUZ

EXECUTIVE SUMMARY: Increases withholding on the sale of Hawaii real property from 5% to 9%. This appears clearly excessive given that the maximum capital gains tax rate for individuals is 7.25% and for corporations is 4%.

SYNOPSIS: Amends section 235-68, Hawaii Revised Statutes, to change the applicable withholding rate from 5% to 9%.

EFFECTIVE DATE: Taxable years beginning after December 31, 2017.

STAFF COMMENTS: Section 235-68, Hawaii Revised Statutes, requires withholding of income tax on the disposition of real property held by a nonresident. This withholding is sometimes known as HARPTA, an acronym for Hawaii Real Property Tax Act.

HARPTA is commonly misunderstood as a tax. It is not a tax. HARPTA was enacted to provide a means for the state to collect capital gains taxes from absentee owners. HARPTA is very similar to laws passed by several other states as well as to a federal law that applies to non-US citizens that sell real estate (which is called FIRPTA, an acronym for Foreign Investment in Real Property Tax Act).

Under HARPTA, an estimate of the owner's capital gains taxes is withheld at closing. When the selling owner subsequently files a Hawaii tax return, the owner then computes the proper tax liability and can then get a refund of any tax previously paid but that is not owed. HARPTA is a payment of tax just like wage withholding or estimated tax payments would be.

To be a valid withholding device, HARPTA should be designed to collect a reasonable estimate of taxes owed. The maximum capital gains tax rate for individuals is 7.25%, and that for corporations is 4%, so a 9% withholding appears clearly excessive. By comparison, FIRPTA withholding is 15% where individual capital gains rates range from 0% to 25% and corporate capital gains are taxed at ordinary income rates up to 35% (prior to 2018) or 21% (2018 and afterward).

Digested 1/26/2018

HAWAII ASSOCIATION OF PUBLIC ACCOUNTANTS

Organized August 7, 1943
P.O. BOX 61043
HONOLULU, HAWAII 96839

AFFILIATE OF

Before the Committee on Ways and Means
Monday, January 29, 2018
Conference Room 211

Re: Support for SB2506 with Comments

Chair Dela Cruz, Vice Chair Keith Agaran, and Committee Members:

The Hawaii Association of Public Accountants (HAPA), a statewide organization of public accounting practitioners consisting primarily of small to mid-sized CPA firm owners and employees, supports the intent of this bill, with comments.

This bill increases the withholding rate when Hawaii real estate is sold by a nonresident seller from 5% to 9%. This withholding tax is commonly referred to as "HARPTA" and the reason for withholding on the sale is similar to the Foreign Investment in Real Property Tax Act (referred to as "FIRPTA") withholding at the Federal level. The original HARPTA withholding rate was 9%, but was lowered to 5% effective August 1, 1991.

For FIRPTA, the purpose is to withhold and prepay the estimated amount of taxes which may be due on the gain on the disposition of a U.S. Real Property Interest from foreign persons. The withholding tax, which may be more or less than the foreign person's final U.S. tax obligation, is credited on the foreign person's U.S. income tax return. Similarly, any HARPTA tax withholding is credited on the nonresident seller's Hawaii income tax return which reports the sale of real estate. The HARPTA withholding is not a separate tax, but is a withholding mechanism to ensure that proper taxes are filed and paid by the seller upon the sale of Hawaii real estate.

The HARPTA withholding requirement does not apply if the seller of the property furnishes the buyer a certification that 1) the seller is a resident person, 2) the seller is exempt from taxation due to a nonrecognition provision under Hawaii law, or 3) for the year preceding the date of transfer, the seller used the property as a residence and the amount realized for the property does not exceed $300,000. The seller can also receive a waiver or adjustment of the amount to be withheld by submitting to the Department of Taxation an application stating that the seller will not realize gain on the transaction or that the total sales proceeds will be insufficient to pay the withholding tax after payment of all sales costs, including any mortgage or lien against the property.

Although the maximum capital gains tax rate is 7.25%, there are reasons why a higher HARPTA withholding rate is desirable. Once real estate is sold by a foreign and out-of-state seller, it is more difficult and costly to collect unpaid taxes from them. Although the 5% HARPTA withholding rate may be sufficient to collect any income taxes due on the sale of the real estate, it is insufficient to recover taxes from those nonresident sellers who failed to file and pay their Hawaii General Excise taxes, Transient Accommodations taxes, and net income taxes generated by Hawaii rental income from the real estate being sold.

As tax practitioners, our members are aware of many instances where Hawaii General Excise taxes, Hawaii Transient Accommodations taxes, and nonresident income tax returns were not filed for rental income received by nonresident taxpayers. For those who are nonresidents who reside in other states or foreign countries, the sale of Hawaiian real estate may be the last good opportunity to collect taxes from those who have profited from Hawaii real estate appreciation and rental income. Unfortunately, many, if not most, out-of-state tax preparers are not familiar with Hawaii tax obligations on rental income or Hawaii tax filing requirements.

As such, we suggest the following be considered:

1. That upon purchasing Hawaii real estate, the purchaser is provided with written notification of Hawaii General Excise and Transient Accommodation tax obligations should the real estate be rented.

2. That upon sale of Hawaii real estate that is not otherwise exempt, the seller should be subject to the higher HARPTA withholding rate of 9% rather than 5% unless he/she certifies that if the real estate being sold was rented at any time within the last seven years prior to sale, that 1) seller has filed tax returns and paid all Hawaii General Excise Taxes and Hawaii Transient Accommodations Taxes due on the rental income received, and 2) seller has filed nonresident income returns reporting the net rental income from the property and paid the requisite taxes. If the seller has not certified that Hawaii taxes were paid on rental income collected within the last seven years and that related tax returns were filed, such notification shall be provided to the Department of Taxation by the escrow company.

3. That consideration be given to adding provisions for dispositions by corporations holding Hawaii real estate, similar to FIRPTA requirements on sales or exchanges of stock in U.S. Real Property Holding Corporations.

We understand that a 9% HARPTA withholding rate may not cover the outstanding Hawaii General Excise, Hawaii Transient Accommodation, and Hawaii income taxes that were due, but some effort to collect unreported taxes is better than none. With a higher HARPTA withholding rate, more nonresident taxpayers would also be inclined to file a Hawaii nonresident return to report the gain on the sale of property rather than forego Hawaii tax reporting requirements.

Thank you for this opportunity to testify. Please do not hesitate to contact us if you have any questions concerning this matter.

Respectfully submitted,

Brian M. Iwata	*Marilyn M. Niwao*
Brian M. Iwata, CPA HAPA State President	Marilyn M. Niwao, M.S.P.H., J.D., CPA, CGMA HAPA Legislative Committee Chairperson

SENATE COMMITTEE ON

WAYS & MEANS

COMMENTS ON TESTIMONY IN SUPPORT OF SB 2506

(WRITTEN TESTIMONY ONLY)

Monday, January 29, 2018

10:15 am

Conference Room 211

Dear Chair Dela Cruz, Vice Chair Keith-Agaran, and members of the Senate Ways and Means Committee:

While I take no position on the increase in withholding tax rate from 5.0% to 9.0%, I offer the following comments on SB 2506. While I am the current Chair of the State of Council of Revenues and former state tax director, I offer my comments in my personal capacity.

SB 2506 proposes to increase the Hawaii withholding tax rate from 5.0% to 9.0% on sales or exchanges of Hawaii real property interests. In 2017, the IRS increased the comparable withholding tax rate from 10.0% to 15.0%, or by 50%. This withholding tax is a provisional or estimated tax for income taxes. In addition to certain exemptions from the withholding tax, a seller can obtain a refund of any excess federal and Hawaii income taxes paid or will owe additional federal and Hawaii income taxes if the withholding taxes are insufficient.

In my experience, there are a fairly significant number of non-Hawaii sellers of Hawaii real property interests who are unaware of or otherwise fail to file and pay the proper 4.5%/4.0% Hawaii general excise tax (GET) and, if applicable, the transient accommodations tax which is currently 10.25% (previously 9.25%). For example, such non-Hawaii taxpayers may rent their Hawaii real property on a monthly or longer basis, or on short-term basis, e.g., Air BNB, and by a condo-hotel pool.

Under the federal tax law equivalent under IRC (26 U.S.C.) Sections 897 and 1445, i.e., FIRPTA (Foregn Investment in Real Property Tax Act (FIRPTA)), the

withholding tax of 15%, applies beyond sales or exchanges of direct real property interests.

For example, the 15.0% FIRPTA withholding applies to sales or exchanges of *stock* in U.S. Real Property Holding Corporations (USRPHC)(defined in IRC Section 897(c)(2)). A USRPHC is defined as a stock in a U.S. corporation that has at least 50% U.S. real property interests which is defined in IRC Section 897(c)(1). Hawaii's equivalent under HRS Section 235-68 (HARPTA) does not currently apply sales or exchanges in USRPHCs (stock in corporations that own at least 50% U.S. real property interests) including the portion attributable to Hawaii real property interests. Thus, a non-Hawaii person may currently sell or exchange stock in a USRPHC even if consists solely of Hawaii real property without any HARPTA withholding tax under HRS Section 235-68.

Another example of when FIRPTA applies but HARPTA does not, is the sale or exchange by a Hawaii partnership, estate or trust, or a non-Hawaii partnership that is registered to do business in Hawaii, which are generally exempt from the HARPTA withholding taxes. Under FIRPTA, the partnership, estate or trust must withhold the FIRPTA tax (IRC Section 1445(e)) that is attributable to a foreign partnership or beneficiary. This ensures that the FIRPTA tax is collected from a foreign partner or beneficiary. Hawaii lacks the equivalent mechanism under HRS Section 235-68 to ensure that the HARPTA tax is collected from a non-Hawaii partner or beneficiary.

Finally, the new federal tax law IRC Section 1446(f), applies a 10% withholding tax to a foreign partner's sale or exchange of a partnership interests to the extent of U.S. business assets. This new provision applies to sales or exchanges of ownership in such entities as limited liability companies and partnerships to the extent attributable to the U.S. business assets (i.e., assets generating U.S. effectively connected income including equipment, vehicles, and other tangible and intangible business assets). Hawaii lacks such a withholding tax.

Thank you for the opportunity to provide my comments.

Colleen Takamura
41 Keapua Street
Wailuku, Hawaii 96793

Before the Committee on Ways and Means

Testimony of Colleen Takamura

Monday, January 29, 2018 at 10:30 a.m.

Conference Room 211

Re: Support for SB 2506 with Comments

Chair Dela Cruz, Vice-Chair Keith Agaran, and Committee Members:

I am a CPA and practice public accounting on the island of Maui. I am also the Maui Chapter President of the Hawaii Association of Public Accountants. I have worked in the accounting profession for 42 years. I started working for the father's accounting practice when I was 16 years old doing keypunching (before we had individual computers), then doing bookkeeping work and tax returns. I went to the University of Denver and obtained my Bachelor's of Science in Accounting and to the Ohio State University and obtained my Master's in Accounting. I worked I public accounting and received my CPA license in 1986.

I support SB2506 with comments. HARPTA is a withholding for taxes – not a tax, similar to Foreign Investment in Real Property Tax Act (FIRTA) on the Federal level. The withholding comes into play when Hawaii real estate is sold by a nonresident seller. The HARPTA withholding rate initially was set at 9% but was reduced to 5% in 1991.

For FIRPTA, the purpose is to withhold and prepay the estimated amount of taxes which may be due on the gain on the disposition of a U.S. Real Property Interest from foreign persons. The withholding tax, which may be more or less than the foreign person's final U.S. tax obligation, is credited on the foreign person's U.S. income tax return. Similarly, any HARPTA tax withholding is credited on the nonresident seller's Hawaii income tax return which reports the sale of real estate. The HARPTA withholding is not a separate tax, but is a withholding mechanism to ensure that proper taxes are filed and paid by the seller upon the sale of property.

The HARPTA withholding requirement does not apply if the seller of the property furnishes the buyer a certification that 1) the seller is a resident person, 2) the seller is exempt from taxation due to a nonrecognition provision under Hawaii law, or 3) for the year preceding the date of transfer, the seller used the property as a residence and the amount realized for the property does not exceed $300,000. The seller can also receive a waiver or adjustment of the amount to be withheld by submitting to the Department of

Taxation an application stating that the seller will not realize gain on the transaction or that the total sales proceeds will be insufficient to pay the withholding tax after payment of all sales costs, including any mortgage or lien against the property.

Although the maximum capital gains tax rate is 7.25%, there are reasons why a higher HARPTA withholding rate is desirable. Once real estate is sold by a foreign and out-of-state seller, it is more difficult and costly to collect unpaid taxes from them. Although the 5% HARPTA withholding rate may be sufficient to collect any income taxes due on the sale of the real estate, it is insufficient to recover taxes from those nonresident sellers who failed to file and pay their Hawaii General Excise taxes, Transient Accommodations taxes, and net income taxes generated by Hawaii rental income from the real estate being sold.

As tax practitioners, our members are aware of many instances where Hawaii General Excise taxes, Hawaii Transient Accommodations taxes, and nonresident income tax returns were not filed for rental income received by nonresident taxpayers. For those who are nonresidents who reside in other states or foreign countries, the sale of Hawaiian real estate may be the last good opportunity to collect taxes from those who have profited from Hawaii real estate appreciation and rental income. Unfortunately, many, if not most, out-of-state tax preparers are not familiar with Hawaii tax obligations on rental income or Hawaii tax filing requirements.

As such, we suggest the following be considered:

1. That upon purchasing Hawaii real estate, the purchaser is provided with written notification of Hawaii General Excise and Transient Accommodation tax obligations should the real estate be rented.

2. That upon sale of Hawaii real estate that is not otherwise exempt, the seller should be subject to the higher HARPTA withholding rate of 9% rather than 5% unless he/she certifies that if the real estate being sold was rented at any time within the last seven years prior to sale, that 1) seller has filed tax returns and paid all Hawaii General Excise Taxes and Hawaii Transient Accommodations Taxes due, and 2) seller has filed nonresident income returns reporting the net rental income from the property and paid the requisite taxes. If the seller has not certified that Hawaii taxes were paid on rental income collected within the last seven years and that related tax returns were filed, such notification shall be provided to the Department of Taxation.

3. That consideration be given to adding provisions for dispositions by corporations holding Hawaii real estate, similar to FIRPTA requirements on sales or exchanges of stock in U.S. Real Property Holding Corporations.

We understand that a 9% HARPTA withholding rate may not cover the outstanding Hawaii General Excise, Hawaii Transient Accommodation, and Hawaii income taxes that were due, but some effort to collect unreported taxes is better than none. With a

higher HARPTA withholding rate, more nonresident taxpayers would also be inclined to file a Hawaii nonresident return to report the gain on the sale of property rather than forego Hawaii tax reporting requirements.
Thank you for this opportunity to testify.

Respectfully submitted,

Colleen M. Takamura

Colleen M. Takamura
CPA license #2374

SB-2506
Submitted on: 1/26/2018 9:02:45 AM
Testimony for WAM on 1/29/2018 10:15:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Mark White	Convention of States	Oppose	No

Comments:

Aloha Committee Chair and Members,

I am submitting this testimony on behalf of myself only, as a resident of Hawaii, not on behalf of Convention of States Hawaii, of which I serve as volunteer State Director.

I do not support SB 2506 which increases the taxable penalty on real property sales, i.e. home ownership, from 5 to 9%. I understand this is intended to apply to non-residents. However, this bill's primary impact will be to hinder the transfer of non-resident ownership realty property to Hawaii resident ownership, further restricting the availability of housing in an already severely limited market segment--namely affordable housing available for our under-advantaged residents.

We must ask ourselves: what are we trying to do here in Hawaii? Are we trying to alleviate a shortage of housing in Hawaii or not? If that is our goal, then remembering the old adage--If you want less of something, then tax it more--we must not support a tax increase on the sale of property in Hawaii.

Mahalo and Aloha,

Mark White

94-217 Olua Place

Waipahu HI 96797

SB-2506
Submitted on: 1/26/2018 4:11:44 PM
Testimony for WAM on 1/29/2018 10:15:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Ray Oda		Support	No

Comments: