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To:	The Honorable Sylvia Luke, Chair and Members of the House Committee on Finance
Date:	Wednesday, March 21, 2018
Time:	2:00 P.M.
Place:	Conference Room 308, State Capitol
From:	Linda Chu Takayama, Director Department of Taxation

Re: S.B. 508, S.D. 1, Relating to Taxation

The Department offers the following comments on S.B. 508, S.D. 1. This measure increases the amount of taxes that must be withheld from the disposition of Hawaii real property by nonresidents from 5% of the amount realized to 9% of the amount realized. The measure is effective upon approval and applies to real estate dispositions that occur on or after 9/15/2018.

First, the Department notes that the original version S.B. 508 is a carryover measure from the 2017 Regular Legislative Session which provided for a refundable Hawaii working family tax credit set at 10% of the federal earned income tax credit.

Second, the Department notes that the new proposed withholding rate may be excessive, since the amount withheld 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 measure with its current effective date. Thank you for the opportunity to provide testimony.

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 508, SD-1

INTRODUCED BY: Senate Committee on Ways and Means

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: This Act, upon its approval, shall apply to real estate dispositions that occur on or after September 15, 2018

STAFF COMMENTS: The language of this proposed SD-1 appears to be from SB 2506 as originally introduced.

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).

The Senate Ways and Means committee report states that the Department of Taxation has projected that increasing the withholding rate to 9% will generate for the State $15,600,000 for fiscal year 2019 and $4,600,000 for fiscal year 2020 and each fiscal year thereafter. A huge revenue gain like that means either that (1) the withheld amount is being used to pay income tax that otherwise wouldn't be paid, or (2) it's being intercepted to pay other kinds of taxes, such as general excise and transient accommodations taxes on rental income that is coming from the property, that weren't getting paid and were brought to light when the property got sold. If the revenue gain goes up even when the withholding rate is higher than the income tax rate, it means the problem isn't income tax; it's the GET and TAT that aren't being paid.

If that's the real problem, this bill isn't the right solution. The solution needs to focus on the GET and TAT, which need to be paid on an ongoing basis rather than caught by chance in the end when the property is sold. So, how about imposing a withholding requirement on property managers or rental pool operators? It may be a bit of extra paperwork, but it may be better than requiring the rest of us to pay higher and more burdensome taxes to make up for the scofflaws, the blissfully ignorant, and others who owe the GET and TAT but aren't paying it.

Digested 3/19/2018

Rental By Owner
Awareness Association

The House of Representatives
The Twenty-Ninth Legislature
Regular Session of 2018

To: Representative Luke, Chair Representative Cullen, Vice-Chair

Date: March 21, 2018 Time: 14:00 p.m.

Place: Conference Room 415

RE: **Senate Bill 508 SD1, Relating to Taxation**

Chair Luke and Members of the Committee:

RBOAA provides **COMMENTS ONLY**.

RBOAA acknowledges the right of the government to set tax rates. This Bill proposes to increase the rate of withholding under HARPTA.

The Bill seems not to acknowledge that HARPTA is a withholding tax, not a permanent tax. As a result, it will not increase tax revenues. It is a refundable deposit. It is a tax only on those people too stupid to claim back their over-payment.

If the increase is necessary because the old rate no longer adequately reflects the effective tax rates on capital gains, then the rate increase is justified. However, testimony from the DoT when this Bill was in the Senate did not support that.

If the increase is proposed in order to capture previously under-reported TAT and GET, the Bill does not indicate how the DoT will determine a taxpayer's liability beyond income and capital gains tax and so, RBOAA fails to see how raising the withholding rate will further advance the DOT's efforts in identifying and collecting under-reported TAT.

Thank you for the opportunity to testify on this measure.

Sincerely,

Neal Halstead
President,
Rental by Owner Awareness Association

29 S. Kukui Place, Kihei, HI 96753

Rental By Owner Awareness Association (RBOAA) is a Hawaii non-profit corporation founded in 2011, with over 1000 members. Our mission is to provide Hawaii vacation-rental property owners with information to help them comply with the applicable State and County regulations, support the Hawaii economy by offering visitors choice in accommodation, and advocate for the rights of Hawaii vacation property owners. RBOAA members provide transient vacation rentals in full compliance with existing tax and County regulations. RBOAA fully supports enforcement of existing regulations.

SB-508-SD-1
Submitted on: 3/20/2018 12:57:50 PM
Testimony for FIN on 3/21/2018 2:00:00 PM

Submitted By	Organization	Testifier Position	Present at Hearing
John Chang	Coalition for Equal Taxation	Oppose	No

Comments:

We respectfully OPPOSE SB 508 and request that the Bill be Deferred.

HB 508 proposes to increase the taxes withheld on the amount realized by nonresidents from the disposition of Hawaii real property from 5% to 9%, commonly referred to as HARPTA. We note that there is not a preamble on this Bill to express what the State's objective and purpose is.

The DoTAX has testified on a similar Bill that the 5% currently being withheld is adequate to address the expected capital gains on the sale of real property.

Thank you for the opportunity to testify.

LATE

46-063 Emepela Pl. #U101 Kaneohe, HI 96744 · (808) 679-7454 · Kris Coffield · Co-founder/Executive Director

TESTIMONY FOR SENATE BILL 508, RELATING TO TAXATION

House Committee on Finance
Hon. Sylvia Luke, Chair
Hon. Ty J.K. Cullen, Vice Chair

Wednesday, March 21, 2018, 2:00 PM
State Capitol, Conference Room 308

Honorable Chair Luke and committee members:

I am Kris Coffield, representing IMUAlliance, a nonpartisan political advocacy organization that currently boasts over 400 members. On behalf of our members, we offer this testimony in support of Senate Bill 508, SD 1, relating to taxation.

We support the revenue generation initiative undertaken by this bill, which would send approximately $15.6 million flowing into our state's coffers for fiscal year 2019 (a lower revenue estimate of $14.4 million has also been reported) and $4.6 million every year thereafter. Our state needs additional revenue to care for the homeless, build affordable housing, provide a quality education to all of our keiki, nurture and protect our natural resources, and more. Increasing revenue to meet these needs is imperative in any year, even more so at a time when the federal government is imposing a system of fiscal austerity that will trim funding for basic services.

HARPTA–the withholding tax of sales of Hawai'i real property by nonresident persons–is patterned after the federal Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) and intended to ensure compliance with income tax law by nonresidents by requiring the purchaser of real property in Hawai'i to withhold a percentage of the amount realized on the disposition of the real property and forwarding that amount to the state. Increasing this withholding would, thus, help Hawai'i's citizens at the expense of those who use the islands at their private monopoly board. Mahalo for the opportunity to testify in support of this bill.

Sincerely,
Kris Coffield
Executive Director
IMUAlliance