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

Date: Wednesday, February 28, 2018
Time: 10:30 A.M.
Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

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

The Department of Taxation (Department) offers the following comments regarding S.B. 508, Proposed S.D. 1, for your consideration. 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 September 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 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, Proposed 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: Applies 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).

Digested 2/26/2018

The Senate
The Twenty-Ninth Legislature
Regular Session of 2018

To: Senator Dela Cruz, Chair Senator Keith-Agaran, Vice-Chair

Date: February 28, 2018 Time: 10:30 a.m.

Place: Conference Room 211

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

Chair Dela Cruz and Members of the Committee:

RBOAA provides **COMMENTS ONLY**.

This Bill proposes to increase the rate of withholding under HARPTA, however, provides no justification for the rate increase so the reader is left to presume the rationale.

If the increase is necessary because the old rate no longer adequately reflects the effective tax rates on capital gains and recapture, then the rate increase is justified.

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.

RBOAA commends the accomplishments of the Department of Taxation in identifying and collecting under-reported GET and TAT, but we fail to see how raising the withholding rate will further advance the efforts of the DoT in this regard.

RBOAA acknowledges the right of the government to set tax rates, including tax prepayment rates, as appropriate to meet the financial obligations of the government.

Thank you for the opportunity to testify on this measure.

Sincerely,

Neal Halstead
President,
Rental by Owner Awareness Association

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.

29 S. Kukui Place, Kihei, HI 96753

Coalition for Equal Taxation

SB508 SD1 Proposed
Hearing 2/28/2018 - Ways and Means

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

The Coalition for Equal Taxation supports lawful collection and payment of all taxes due. However, we must **OPPOSE SB508 SD1** that proposes to raise the HARPTA withholding from 5% to 9%. The purpose of this change is for the Department of Taxation to withhold sums of money beyond what is necessary for the capital gains tax to apply to any other potential tax liability that the nonresident seller of property may owe.

The purpose of HARPTA is a pre-payment towards capital gains that would be due, however, to withhold additional sums for other purposes is very problematic.

This Bill in effect, views nonresident owners as a "suspected class" and on that basis justifies retaining money from nonresidents to determine if they are guilty of tax evasion and crimes. This presumes they are more likely to have committed a crime than a resident who may file an exemption to withholding.

In 2012 Act 326 and later Act 204 was passed that provided for even easier investigation of operators who are not in compliance and provides for the DoTAX quicker methods of investigation since each operator must post a TAT number in advertising.

In 2016 (year 2016 to 2017) the DoTAX finally started to implement significant and wide scale investigation through data mining analytics. This data mining allows them to "identify non-filers and under-reporters of Transient Accommodations Taxes." (DoTAX annual report). For year 2017 they recouped 1M of TAT revenue and expect 2018 to be 2M.

Your DoTAX has the tools necessary to investigate and recoup taxes owed. However, this has only really been started since 2016. The DoTAX does not need to wait until a nonresident sells property to determine if they owe TAT.

This Bill is not needed as an enforcement tool. The State has already enacted tax laws, it is a matter of enforcing those laws, which is now, finally, taking place.

Thank you for the opportunity to testify and we respectfully request this Bill be deferred.