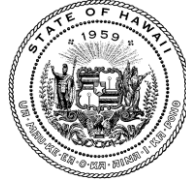


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DEPARTMENT OF TAXATION

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To: The Honorable Donovan M. Dela Cruz, Chair;
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair;
and Members of the Senate Committee on Ways and Means

From: Rona M. Suzuki, Director
Department of Taxation

Re: S.B. 2040, Relating to Taxation

Date: Tuesday, February 4, 2020

Time: 10:30 A.M.

Place: Conference Room 211, State Capitol

The Department of Taxation (Department) provides the following comments regarding S.B. 2040. The measure establishes a surcharge equal to twenty-five per cent of the net proceeds from the sale of residential property for which a homeowner-exemption cannot be claimed, if the property is sold within five years after the date of purchase. The measure is effective on July 1, 2020.

The Department notes that under a voluntary tax compliance system, taxpayers must calculate their own tax, file a return, and pay any taxes due. Because subsection (c) requires this new surcharge to be paid before the transfer may be recorded, the Department believes that it would be more efficient to have the surcharge paid with the existing conveyance tax liability under section 247-2, Hawaii Revised Statutes. To accomplish this, the Department suggests deleting the existing language in subsection (b) and replacing it with subsection (c) to read as follows:

(b) The tax imposed by this section shall be paid in the same manner as the tax due under section 247-2 and at such place or places as the director of taxation may direct and shall be due and payable no later than ninety days after the taxable transaction, and in any event prior to the imprinting of the seal or seals as provided by section 247-5. Penalties and interest shall be added to and become a part of the tax, when and as provided by section 231-39.

The Department also suggests that the date of purchase and the date of sale be established with reference to the date on which the conveyance transaction was recorded at the Bureau of Conveyances or Land Court. The Department suggests amending subsection (f) to read:

(f) For purposes of this section, "date of purchase" and "date of sale" means the date of the agreement of sale or deed under which the property was purchased or sold, as reflected in the document or

instrument recorded or filed with the registrar of conveyances or the assistant registrar of the land court, as applicable.

The Department notes that “net proceeds” is not defined in this measure. The Department strongly suggests that a definition be inserted as this definition has a direct impact on the amount of surcharge that will be due. One possible definition of “net proceeds” is:

“Net proceeds” means the sales price, including the fair market value of all non-cash consideration received in the transaction, less all amounts paid to satisfy any liens or encumbrances on the property, other than a lien or encumbrance for which no consideration was given, all direct costs of sale, and closing costs.

The Department notes that the surcharge is imposed where the seller/taxpayer may have received the property through a bequest or gift. The Legislature may want to consider excluding these seller/taxpayers from this measure.

Finally, the Department respectfully requests that the measure be made effective no earlier than January 1, 2021. This will allow sufficient time for the Department to make necessary changes to forms and instructions.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: CONVEYANCE, Flipping Surcharge

BILL NUMBER: SB 2040

INTRODUCED BY: S. CHANG, FEVELLA, HARIMOTO, KANUHA, MORIWAKI

EXECUTIVE SUMMARY: Establishes a surcharge equal to twenty-five per cent of the net proceeds from the sale of certain residential property within a period of five years after the date of purchase if the owner is ineligible for a county homeowner's exemption on property tax.

SYNOPSIS: Adds a new section to chapter 247, HRS, providing that any condominium or single family residence sold within a period of five years after the date of purchase and for which the owner is ineligible for a county homeowner's exemption on property tax shall be levied a surcharge equal to twenty-five per cent of the net proceeds from the sale.

Also provides that any person or entity who sells a condominium or single family residence for which the person or entity is ineligible for a county homeowner's exemption on property tax and who sells the property within five years of the purchase shall notify the director of taxation in writing of the purchaser's intention. The notice shall specify the property's address, date of purchase, original purchase price, date of sale, and sale price. Within thirty days after the receipt of the notice, the director of taxation shall notify the person or entity in writing at the specified address the amount of surcharge taxes owed, if applicable.

The tax is to be paid no later than 90 days after the taxable transaction, and must be paid before the bureau imprints the official seal on the conveyance or other sale document.

The surcharge shall not be applicable to a sale under foreclosure by a mortgagee of any lot, or to the transfer of title by a mortgagee after foreclosure or otherwise to any agency of the United States government pursuant to the terms of any insurance or guarantee of mortgage loan by such agency, or to any subsequent purchaser.

Amends section 247-7, HRS, to provide that surcharge collections are to be directed to the rental housing revolving fund.

EFFECTIVE DATE: July 1, 2020.

STAFF COMMENTS: The surcharge proposed appears to be a "sin tax." Apparently, the evil sought to be punished is buying a piece of residential property and then selling the same property within five years.

Typically, however, a "flip" sale is made when a person buys a property, perhaps under distressed circumstances such as a foreclosure sale; adds value to it by fixing things, refurbishing the interior, or making more substantial improvements; and then sells the property to monetize the value added. What is legally or morally undesirable about that sequence of events?

In addition, what would prevent the person from moving in and living in the house for a limited period just before sale? That would make the property eligible for a county homeowner's exemption so the tax would not be applicable. Is it intended that it would be that easy to avoid the levy?

Finally, suppose a person is given a long-term job assignment (or military station) here and moves here with family in tow but does not want to give up primary residency. The long-term assignment ends and the person is assigned to another state. He sells the house here to buy one in the location of the next long-term assignment. Should the punitive tax apply?

If it is desired to enact a "sin tax," the legislature should be careful to tightly define the "sin" so that there are no undesirable consequences. The bill as currently drafted appears to be overinclusive.

Digested 1/30/2020



SB 2040, RELATING TO TAXATION

FEBRUARY 4, 2020 · SENATE WAYS AND MEANS
COMMITTEE · CHAIR SEN. DONOVAN DELA CRUZ

POSITION: Support.

RATIONALE: IMUAlliance supports SB 2040, relating to taxation, which establishes a surcharge equal to twenty-five per cent of the net proceeds from the sale of certain residential property within a period of five years after the date of purchase if the owner is ineligible for a county homeowner's exemption on property tax.

Today, **the lack of affordable housing exacerbates the economic insecurity suffered by local families, which sex traffickers use to prey upon potential victims with false promises of financial stability and prosperity.** Hawai'i residents face the highest housing costs in the nation, at more than twice the national average. Researchers who authored the National Low Income Housing Coalition's *Out of Reach 2019* report found that a full-time worker would need to earn \$36.82/hour to afford a two-bedroom apartment at fair market value in our state, with Honolulu experiencing a 67 percent increase in fair market rent between 2005 and 2015.

Average rent for a two-bedroom unit surpassed \$2,000 in recent years, with minimum wage workers needing to log 111 hours per week to afford a modest one-bedroom apartment at fair market value and 146 hours per week to afford a two-bedroom—a number that is equivalent to working over 20 hours a day with no days off year-round. In the past five years alone, Honolulu rent has increased by more than 25 percent. While 43 percent of Hawai'i residents are renters (a number that does not include individuals and families renting outside of the regulated rental

market), they earn an average wage of \$16.68/hour, according to NLIHC, scarcely enough to meet their basic needs.

One out of every four households in Hawai'i report that they are "doubling up" or are three paychecks or less away from being homeless, per the Hawai'i Appleseed Center for Law and Economic Justice. Additionally, 63 percent of households are severely cost-burdened, following NLIHC data, meaning that they pay more than 30 percent of their income for housing costs, a number that rises to 83 percent of extremely low-income households, with only 74 homes available for every 100 households earning 80 percent of their respective area's median income.

Unsurprisingly, our state is now experiencing population decline. Hawai'i saw domestic out-migration increase for a third consecutive year in 2019, as the state's high cost of living continued to push people to the mainland. Census estimates show that our state's population dropped by more than 4,700 people, to 1,415,872, from July 2018 to July 2019, when births, deaths, and migration were accounted for. That's the biggest numerical population drop since 2015 and it made Hawai'i one of just ten states in the country to lose population in 2019, according to the U.S. Census Bureau. People are simply being priced out of paradise.

Implementing a flipping surcharge will disincentivize the short-term real estate speculation that reduces our housing and rental supplies and rapidly inflates housing costs. We cannot continue to allow the islands to be used as a stock market for wealthy, unscrupulous investors. To ensure that our islands are affordable for ourselves and future generations, we must take bold action ***now*** to protect our housing inventory for working families.

February 4, 2020

The Honorable Donovan Dela Cruz, Chair
Senate Committee on Ways and Means
State Capitol, Room 211
Honolulu, HI 96813

RE: S.B. 2040, Relating to Taxation

HEARING: Tuesday, February 4, 2020, at 10:30 a.m.

Aloha Chair Dela Cruz, Vice Chair Keith-Agaran and Members of the Committee,

I am Ken Hiraki, Director of Government Affairs, testifying on behalf of the Hawai'i Association of REALTORS® ("HAR"), the voice of real estate in Hawai'i, and its over 10,000 members. HAR **strongly opposes** S.B. 2040 which establishes a surcharge equal to 25% of the net proceeds from the sale of certain residential property within a period of five years after the date of purchase if the owner is ineligible for a county homeowner's exemption on property tax.

Under this measure, if a property owner buys an investment property and sells it within 5 years, a 25% tax would be applied to the net proceeds. Net proceeds are the final sale price of a property less any costs of selling your home, such as excise taxes, legal fees, property liens, commissions, outstanding mortgage, etc. If there is no outstanding mortgage on the property, the amount of the net proceeds could be extremely high and confiscatory. Additionally, HAR would note that this would be in addition to the capital gains tax.

Additionally, there are multiple reasons why a person would need to sell their investment property within 5 years—having to move for work, divorce, experiencing financial difficulty to name a few. Selling a property within 5 years is not always due to flipping.

Furthermore, this would be devastating to the affordable housing market. In many cases owners invest in dilapidated properties in order to put otherwise uninhabitable homes back on the market. This bill discourages rather than encourages that activity.

We are in a severe housing shortage, with over 65,000 units needed in Hawai'i by 2025 according to the Department of Business, Economic Development and Tourism. We need to be encouraging investment in housing at all price points, and this measure would be counterproductive to Hawaii's unique housing challenges.

Mahalo for the opportunity to testify.

SB-2040

Submitted on: 2/1/2020 11:14:51 AM

Testimony for WAM on 2/4/2020 10:30:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Richard Emery	Individual	Oppose	No

Comments:

There is no justification for this additional tax. Sellers already pay capital gains tax.