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# A BILL FOR AN ACT

RELATING TO LEASEHOLD CONVERSION.

**BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:**

1           SECTION 1. The legislature finds that, in 1967, in  
2 response to ideological forces fighting an oligopolistic land  
3 tenure system in Hawaii and spurred on by more practical reasons  
4 of increasing lease rents on renegotiations, the legislature  
5 enacted Act 307, Session Laws of Hawaii 1967 (Act 307), codified  
6 as chapter 516, Hawaii Revised Statutes, relating to residential  
7 leaseholds.

8           Chapter 516, Hawaii Revised Statutes, allows lessees of  
9 long-term leasehold interests in single-family residential  
10 development tracts the right to purchase the fee interest of  
11 their residential lots through a condemnation process involving  
12 the fee simple landowner and what is now the housing and  
13 community development corporation of Hawaii. The latter party  
14 would condemn the fee interest, paying the fee owner fair  
15 compensation for the fee interest and, in turn, sell the  
16 acquired fee interest to the leasehold homeowner. In 1984,  
17 following extended litigation, the United States Supreme Court  
18 ruled in Hawaii Housing Authority v. Midkiff, that Act 307 did



1 not violate the United States Constitution. Shortly thereafter,  
2 in Hawaii Housing Authority v. Lyman, the Supreme Court of Hawaii  
3 also found that Act 307 did not violate the state constitution.  
4 As a result, over the last twenty-five years, the number of  
5 leasehold single-family residences fell from a high of  
6 approximately twenty-eight thousand to four thousand six  
7 hundred.

8 The legislature also finds that, following the successful  
9 effort in substantially reducing the leasehold system in Hawaii  
10 as applied to single-family dwelling, many owners of multi-  
11 family residential leasehold units facing lease rent  
12 renegotiations, including cooperative housing corporations,  
13 condominiums, and planned development housing, aspired to be  
14 able to purchase the fee interests under their multi-family  
15 units. Over the years, numerous bills were introduced to extend  
16 the right to purchase the fee interest by a multi-family unit  
17 leasehold owner, culminating in 1991 with two bills introduced  
18 in the legislature proposing mandatory leasehold conversion for  
19 multi-family units or, in the alternative, giving the lessor the  
20 option of leasehold conversion or lease rent control. Neither  
21 bill passed the legislature.



1           However, in 1991, the Honolulu city council adopted  
2 ordinance 91-95, which granted multi-family residential  
3 leaseholders the right to purchase the fee simple interest to  
4 their units in a condemnation procedure similar to chapter 516,  
5 Hawaii Revised Statutes. The new ordinance, codified at chapter  
6 38, Revised Ordinances of Honolulu (chapter 38), provided that  
7 at least twenty-five of all the condominium owners (defined as  
8 owner-occupants) or at least owners of a certain percentage of  
9 the condominium units within the development, whichever was  
10 less, could trigger the condemnation process by the city  
11 department of housing and community development. Following the  
12 inevitable court challenge, the United States Ninth Circuit  
13 Court of Appeals, in Richardson v. City and County of Honolulu,  
14 held the ordinance did not violate the United States  
15 Constitution. In 2002, in Coon v. City and County of Honolulu,  
16 the Hawaii Supreme Court upheld the validity of chapter 38.  
17 However, in so doing, the court also held that the rules adopted  
18 to implement chapter 38, relating to determining the minimum  
19 number of applicants required to initiate the conversion  
20 process, violated chapter 38 by impermissibly lowering the  
21 minimum number of applicants required.



1 This prompted the Honolulu city council to attempt to amend  
2 chapter 38 in 2002 by introducing Bill 53, which would bring  
3 chapter 38 in line with the liberal rules for triggering the  
4 conversion process, consequently making it as broadly applicable  
5 as possible. However, this time the proponents were met by a  
6 more organized effort by fee owner lessors seeking to keep the  
7 conversion process comparatively narrow by excluding as many  
8 multi-family projects as possible from the process established  
9 in chapter 38.

10 In response to this opposition, the Honolulu city council  
11 tabled the measure.

12 In January 2005, after decades of heated debate between  
13 proponents and opponents of mandatory residential leasehold  
14 conversion, the Honolulu city council voted to repeal chapter  
15 38, and in February 2005, the mayor of the city and county of  
16 Honolulu approved the repeal measure.

17 The legislature believes that, rather than perpetuate a  
18 process that polarizes members of the community, an incentive-  
19 based approach to the issue should be pursued. To this end, the  
20 legislature believes that providing fee owners of multi-family  
21 or single-family residential leasehold property with the  
22 opportunity, for a limited time, to exclude fifty per cent of



1 any proceeds from the sale of the leased fee interest to the  
2 lessee from their taxable income, but not to exceed \$75,000 of  
3 exclusion in the aggregate for all taxpayers in any tax year,  
4 would provide the proper incentive to sell the fee interest in  
5 their real property.

6 The purpose of this Act is to allow, for a limited time, a  
7 fee owner to exclude from the fee owner's taxable income fifty  
8 per cent of the income derived from the sale of a leased fee  
9 interest in a multi-family or single family residential  
10 leasehold property to the lessee of the multi-family or single  
11 family residential leasehold unit.

12 SECTION 2. Section 235-7, Hawaii Revised Statutes, is  
13 amended by amending subsection (a) to read as follows:

14 "(a) There shall be excluded from gross income, adjusted  
15 gross income, and taxable income:

16 (1) Income not subject to taxation by the State under the  
17 Constitution and laws of the United States;

18 (2) Rights, benefits, and other income exempted from  
19 taxation by section 88-91, having to do with the state  
20 retirement system, and the rights, benefits, and other  
21 income, comparable to the rights, benefits, and other



- 1 income exempted by section 88-91, under any other  
2 public retirement system;
- 3 (3) Any compensation received in the form of a pension for  
4 past services;
- 5 (4) Compensation paid to a patient affected with Hansen's  
6 disease employed by the State or the United States in  
7 any hospital, settlement, or place for the treatment  
8 of Hansen's disease;
- 9 (5) Except as otherwise expressly provided, payments made  
10 by the United States or this State, under an act of  
11 Congress or a law of this State, which by express  
12 provision or administrative regulation or  
13 interpretation are exempt from both the normal and  
14 surtaxes of the United States, even though not so  
15 exempted by the Internal Revenue Code itself;
- 16 (6) Any income expressly exempted or excluded from the  
17 measure of the tax imposed by this chapter by any  
18 other law of the State, it being the intent of this  
19 chapter not to repeal or supersede any such express  
20 exemption or exclusion;
- 21 (7) Income received by each member of the reserve  
22 components of the Army, Navy, Air Force, Marine Corps,

1 or Coast Guard of the United States of America, and  
2 the Hawaii national guard as compensation for  
3 performance of duty, equivalent to pay received for  
4 forty-eight drills (equivalent of twelve weekends) and  
5 fifteen days of annual duty, at an:

6 (A) E-1 pay grade after eight years of service;  
7 provided that this subparagraph shall apply to  
8 taxable years beginning after December 31, 2004;

9 (B) E-2 pay grade after eight years of service;  
10 provided that this subparagraph shall apply to  
11 taxable years beginning after December 31, 2005;

12 (C) E-3 pay grade after eight years of service;  
13 provided that this subparagraph shall apply to  
14 taxable years beginning after December 31, 2006;

15 (D) E-4 pay grade after eight years of service;  
16 provided that this subparagraph shall apply to  
17 taxable years beginning after December 31, 2007;

18 and

19 (E) E-5 pay grade after eight years of service;  
20 provided that this subparagraph shall apply to  
21 taxable years beginning after December 31, 2008;

- 1           (8) Income derived from the operation of ships or aircraft  
2           if the income is exempt under the Internal Revenue  
3           Code pursuant to the provisions of an income tax  
4           treaty or agreement entered into by and between the  
5           United States and a foreign country, provided that the  
6           tax laws of the local governments of that country  
7           reciprocally exempt from the application of all of  
8           their net income taxes, the income derived from the  
9           operation of ships or aircraft that are documented or  
10          registered under the laws of the United States;
- 11          (9) The value of legal services provided by a prepaid  
12          legal service plan to a taxpayer, the taxpayer's  
13          spouse, and the taxpayer's dependents;
- 14          (10) Amounts paid, directly or indirectly, by a prepaid  
15          legal service plan to a taxpayer as payment or  
16          reimbursement for the provision of legal services to  
17          the taxpayer, the taxpayer's spouse, and the  
18          taxpayer's dependents;
- 19          (11) Contributions by an employer to a prepaid legal  
20          service plan for compensation (through insurance or  
21          otherwise) to the employer's employees for the costs





1 of legal services incurred by the employer's  
2 employees, their spouses, and their dependents; [~~and~~]

3 (12) Amounts received in the form of a monthly surcharge by  
4 a utility acting on behalf of an affected utility  
5 under section 269-16.3 shall not be gross income,  
6 adjusted gross income, or taxable income for the  
7 acting utility under this chapter. Any amounts  
8 retained by the acting utility for collection or other  
9 costs shall not be included in this exemption[+]; and

10 (13) Fifty per cent of the income derived by a fee owner  
11 from the sale of a leased fee interest in a multi-  
12 family residential leasehold property to the lessee of  
13 the multi-family residential leasehold unit; or in a  
14 residential leasehold house lot to the lessee of the  
15 residential leasehold house lot; provided that:

16 (A) The terms "fee owner", "leased fee interest", and  
17 "lessee" have the same meanings as defined in  
18 section 516-1;

19 (B) The terms "multi-family residential leasehold  
20 property" and "multi-family residential leasehold  
21 unit" mean property or units within a  
22 "condominium project" or "cooperative project" as

1           those latter terms are defined in section 514C-1;  
2           and  
3           (C) This exclusion shall not exceed \$75,000 in the  
4           aggregate for all taxpayers in the State in any  
5           tax year."

6           SECTION 3. Statutory material to be repealed is bracketed  
7 and stricken. New statutory material is underscored.

8           SECTION 4. This Act shall take effect on July 1, 2006, and  
9 shall apply to taxable years beginning after December 31, 2006,  
10 and ending prior to January 1, 2008; provided that this Act  
11 shall be repealed on January 1, 2008, and the underlying  
12 provisions of section 235-7(a), Hawaii Revised Statutes, shall  
13 be reenacted in the form in which they read on the day prior to  
14 the effective date of this Act.



**Report Title:**

Leased Fee Interest Sale; Capital Gains; Exempt from Taxation

**Description:**

Excludes from taxable income 50% capital gains realized, not to exceed \$75,000 in the aggregate for all taxpayers, during taxable year 2006 from sale of leased fee interest in residential house lot or multi-family residential leasehold property to the lessee. (SD2)

