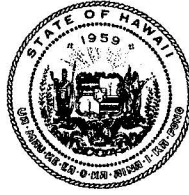


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**HOUSE COMMITTEE ON ECONOMIC REVITALIZATION, BUSINESS &
MILITARY AFFAIRS
TESTIMONY REGARDING HB 1921
RELATING TO CONTROLLING INTEREST TRANSFER TAX**

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)

DATE: FEBRUARY 2, 2010

TIME: 8:30AM

ROOM: 312

This measure proposes a new real property asset conveyance tax to capture the tax on the sale of stock in entities that own Hawaii real property.

The Department of Taxation (Department) **supports the intent of capturing the tax lost due to complex tax advantaged deal structuring**; however prefers a more simpler method.

SUPPORT FOR MINIMIZING THE TAX LOSS FROM STRUCTURING—The intent of this legislation appears to close the "loophole" that is perceived in the taxation of real property transfers where the stock in the entity that owns the property is sold and not the property itself. Though there is nothing inherently wrong with this structuring, it can result in the loss of tax revenue, specifically conveyance tax. The Department supports legislation to capture the proper amount of tax that, in reality and looking through structuring, should be paid for the sale of real property.

SIMPLY MODIFY CURRENT CONVEYANCE TAX—The Department suggests that, rather than an entirely new tax chapter, simply make an amendment to the conveyance tax chapter to "look through" structuring of real property sales through entity equity transactions.

Another alternative could be to assess a personal property tax on the stock transfer of entities that own real property equal to the foregone real property tax. There are several ways to close this gap, which the Department suggests be focused in the conveyance tax law rather than a new chapter.

By modifying the current conveyance tax, the entire tax regime will be applied to the stock sales wholesale, including procedural matters, exemptions, and enforcement.

REVENUE IMPACT—This legislation could result in additional revenue above and beyond what the conveyance tax collects. The Department does not support additional taxes on property transfers, whether through conveyance or by stock transfer. The Department only supports this assessment to the extent it closes an existing loophole.

ASSISTANCE—The Department will make itself available to assist the Committee in drafting language that could close the loophole this measure seeks to close.

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SUBJECT: MISCELLANEOUS, Controlling interest transfer tax

BILL NUMBER: SB 2128; HB 1921 (Identical)

INTRODUCED BY: SB by Taniguchi by request; HB by Choy

BRIEF SUMMARY: Adds a new chapter to HRS to provide for the imposition of a controlling interest transfer tax. The tax will be at the rate of one and eleven one-hundredths of one per cent on the sale or transfer of a controlling interest in any entity, when: (1) the transfer of a controlling interest is made by a seller or transferor or by a group of sellers or transferors acting in concert; provided that sellers or transferors who are related to each other by blood or marriage are presumed, unless shown to the contrary, to be acting in concert; (2) the transfer is made for consideration; (3) the entity in which a controlling interest is being transferred owns an interest in real property in this state; (4) the present true and actual value of the interest in real property equals or exceeds \$2,000; and (5) the controlling interest in an entity transfers real property to a transferee or to a group of transferees acting in concert.

Provides that: (1) where transferees are related and one influences or controls the actions of another (such as parent and subsidiary corporations, parents and children, husbands and wives, etc.), the transferees shall be presumed to be acting in concert; and (2) where transferees have negotiated and will consummate their purchase of ownership interests in unity (such as transfers that are closely related in time, transferees that are few in number, or purchase contracts that contain mutual terms, and agreements among transferees binding them to a course of action with respect to the transfers, etc.), the transferees shall be presumed to be acting in concert.

A taxable sale or transfer of a controlling interest may occur in one transaction or in a series of transactions; provided that transactions that occur within six months of each other are presumed to be a series of transactions.

Stipulates that the controlling interest transfer tax shall not be applicable to: (1) any sale or transfer of a controlling interest in any entity to the extent that the entity possesses, directly or indirectly, an interest in real property located in an area of any county designated as an enterprise zone; or (2) any sale or transfer of a controlling interest in any entity to effectuate a change of identity or form of ownership or organization where there is no change in beneficial ownership.

EFFECTIVE DATE: July 1, 2010; applicable to tax years beginning after December 31, 2009

STAFF COMMENTS: The proposed measure would create a new tax similar to the conveyance tax to ensure that "complex transactions" involving the transfer of real property in the state are taxed, even though they are not current taxable under the conveyance tax as the real property is owned by a legal entity like a corporation or partnership. While it is the intent of the measure to close this loophole as the measure argues that these transfers attempt to evade taxation, it should be noted that the current conveyance tax was never established to be a source of revenue. Only in recent years as lawmakers

sought to fund their favorite programs did the conveyance tax come under fire as a way to raise new sources of revenue to fund these favored programs. With rates as high as \$1.25 per hundred dollars of value transferred, lawmakers now believe that transfers of real property, albeit as part of the acquisition of a company or partnership, are an intentional evasion of the tax. Thus, it is not hard to believe that the proposed modest rate will mushroom in a few years as the imposition of this new tax will be viewed as another way to raise additional revenue.

Unfortunately, this new tax will add another nail in the economic coffin of Hawaii as it is just one more cost that an investor must weigh in deciding whether or not the return on an investment in Hawaii is attractive or reasonable.

It should be remembered that the conveyance tax was initially enacted by the 1966 legislature after the repeal of the federal law requiring stamps for transfers of real property. It was enacted for the sole purpose of providing the department of taxation with additional data for the determination of market value of properties transferred. This information was also to assist the department in establishing real property assessed values and at that time the department stated that the conveyance tax was not intended to be a revenue raising device. The conveyance tax is imposed each time property changes title or ownership. However, over the years, the tax has been increased and conveyance tax revenues have been tapped to provide revenue for the land conservation fund, rental housing trust fund, and the natural area reserve fund. If the proposed controlling interest transfer tax becomes enacted, there may be temptation to extract additional revenue from the new tax by increasing the tax rate in subsequent years. Once a tax has become planted and begins to sprout new tax revenue, such a tax will be difficult to repeal or eliminate.

Digested 2/1/10