TESTIMONY OF THE DEPARTMENT OF THE ATTORNEY GENERAL TWENTY-FIFTH LEGISLATURE, 2010

ON THE FOLLOWING MEASURE:
H.B. NO. 1922, RELATING TO TAXATION.

BEFORE THE:
HOUSE COMMITTEE ON FINANCE

DATE: Wednesday, February 10, 2010 **TIME:** 2:00 p.m.

LOCATION: State Capitol, Room 308

TESTIFIER(S): Mark J. Bennett, Attorney General, or
Mary Bahng Yokota, Deputy Attorney General

Chair Oshiro and Members of the Committee:

The Department of the Attorney General provides these comments regarding legal concerns in this bill.

This bill requires every nonresident person who is a transferor (any person disposing real property that is located in Hawaii) to submit a tax clearance stating that the transferor has filed all tax returns and paid all taxes, penalties, and interest owed to the State before recording any transfer of title of real property involving the transferor. Further, "transferor" is defined as "any person disposing real property that is located in Hawaii" (p. 2, lines 21-22). And, under section 235-1, Hawaii Revised Statutes, the term "person" includes "an individual, a trust, estate, partnership, association, company, or corporation." Thus, this requirement applies to not only individuals who sell real property in Hawaii but also applies to businesses that sell real property in Hawaii.

This bill appears to be facially discriminatory in that it imposes this requirement only on transferors who are nonresidents and not on transferors who are residents. And, the constitutionality of this requirement may be challenged based on

the Equal Protection, Privileges and Immunities, and/or Commerce Clauses.

The guarantee of equal protection of the laws under the Hawaii and United States Constitutions requires that persons similarly situated with respect to the legitimate purpose of the law receive like treatment. State v. Miller, 84 Haw. 269, 276, 933 P.2d 606, 613 (1997) (citing Cleburne v. Cleburne Living Center, Inc., 473 U.S. 432, 440, 105 S. Ct. 3249, 3254 (1985), and State v. Bloss, 62 Haw. 147, 157, 613 P.2d 354, 360 (1980)). "Equal protection does not require that all persons be dealt with identically, but it does require that a distinction made have some relevance to the purpose for which the classification is made." Miller at 276, 933 P.2d at 613 (citing Baxstrom v. Herold, 383 U.S. 107, 113, 86 S. Ct. 760, 763 (1966)). In the absence of a suspect classification or an intrusion upon a fundamental constitutional right, the challenged classification must bear some rational relationship to legitimate state purposes. Miller at 276, 933 P.2d at 613 (citing San Antonio Indep. Sch. Dist. v. Rodriguez, 411 U.S. 1, 40, 93 S. Ct. 1278, 1300 (1973), and Baehr v. Lewin, 74 Haw. 530, 572, 852 P.2d 44, 64, *reconsideration and clarification granted in part*, 74 Haw. 650, 875 P.2d 225 (1993)).

The Privileges and Immunities Clause, United States Constitution, article IV, section 2, provides that "[t]he Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States." The object of the Privileges and Immunities Clause is to "strongly . . . constitute the citizens of the United States one people," by "plac[ing] the citizens of each State upon the same footing with citizens of other States, so far as the advantages resulting from citizenship in those States are concerned." Lunding v. New

York Tax Appeals Tribunal, 522 U.S. 287, 296, 118 S. Ct. 766, 773 (1998). Where nonresidents are subject to different treatment, there must be "reasonable ground for . . . diversity of treatment." Id. at 298, 118 S. Ct. at 774. When confronted with a challenge under the Privileges and Immunities Clause to a law distinguishing between residents and nonresidents, a state may defend its position by demonstrating that (i) there is a substantial reason for the difference in treatment, and (ii) the discrimination practiced against nonresidents bears a substantial relationship to the State's objective. Id.

The Commerce Clause empowers Congress "[t]o regulate Commerce . . . among the several States," United States Constitution, article I, section 8, clause 3, and although its terms do not expressly restrain "the several States" in any way, the courts have sensed a negative implication in the provision since the early days. Department of Revenue of Ky. v. Davis, 553 U.S. 328, 128 S. Ct. 1801, 1808 (2008). The modern law of what has come to be called the dormant Commerce Clause is driven by concern about "economic protectionism - that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." Id. Under the dormant Commerce Clause analysis, the courts ask whether a challenged law discriminates against interstate commerce. Id. A discriminatory law is "virtually *per se* invalid," and will survive only if it "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." Id. Absent discrimination for the forbidden purpose, however, the law "will be upheld unless the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits." Id.

To attempt to avoid these constitutional issues, we respectfully recommend that the bill be amended to: (1) provide that the requirement applies to all transferors without regard to residency by deleting the word "nonresident" (page 6, line 16) and setting forth the requirement in a separate statutory section affecting all disposition of real property (not just the "disposition of real property by *nonresident* persons" as the title of the statute in which the requirement is currently contained reflects); or (2) address the potential constitutional issues by articulating the legitimate government purpose for applying the requirement to only nonresident transferors, how applying the requirement to only nonresident transferors bears a substantial relationship to the legitimate government purpose, how the legitimate government purpose cannot be adequately served by reasonable nondiscriminatory alternatives, and how applying the requirement to only nonresident transferors is not clearly excessive in relation to the putative local benefits.

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

STANLEY SHIRAKI
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

HOUSE COMMITTEE ON FINANCE
TESTIMONY REGARDING HB 1922
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 10, 2010
TIME: 2PM
ROOM: 308

This measure requires a buyer of real property located in Hawaii to obtain a tax clearance from the Department of Taxation (Department) before a conveyance document can be recorded in the Bureau of Conveyances.

The Department **supports the intent** of this legislation and **offers comments**.

STRONG SUPPORT FOR ENSURING NONRESIDENTS PAY THEIR FAIR SHARE OF TAX—That Department strongly supports legislation that ensures all taxpayers, including nonresidents with Hawaii tax obligations, pay their fair share of taxes. With nonresidents specifically, tax compliance can be poor because of unfamiliarity with laws and obligations. In order to ensure nonresidents are aware of their income tax obligations from selling Hawaii property, Hawaii's HARPTA law requires a withholding tax on the buyer where the seller is a nonresident. This withholding tax is patterned after federal law and is an effective way of ensuring that nonresidents are compliant.

SUPPORT FOR THE CONCEPT OF TAX CLEARANCES—Though very resource intensive, the Department supports the concept of tax clearances because they serve as a condition precedent to obtaining whatever action the taxpayer desires, *i.e.*, business permits or the recording of a deed in the case of this bill. There are practical limitations on tax clearances; however, namely that the Department can only clear based upon information reported by a taxpayer. In other words, if a taxpayer lies on their tax return, but pays what they say they owe, they will still get a tax clearance.

TAX CLEARANCE REQUIREMENT SHOULD BE CLARIFIED—Currently, there are other tax clearances required by law. However, the clearance requirement is not clear and is interpreted as "all taxes." Because all taxes must be cleared, obtaining a tax clearance is overly burdensome on the Department's resources. Clearance could be obtain much quicker and easier for

both taxpayers and the Department if the clearances were only for income tax, TAT, and GET. These are the main taxes, rather than tobacco tax, rental motor vehicle tax, etc., which must be cleared under current practice.

RESOURCES—Tax clearances are also very resource intensive for the reasons stated above. The Department would be greatly burdened by this legislation without additional resources and an amendment clarifying that the tax clearance is a limited clearance of the relevant taxes.

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Verification of taxes paid on sale of real property by nonresidents

BILL NUMBER: HB 1922

INTRODUCED BY: Choy

BRIEF SUMMARY: Adds a new paragraph (h) to HRS section 235-68 to require a nonresident person that is a transferor of real property to obtain a certified tax clearance certificate from the department of taxation verifying that the transferor has filed all required returns and paid all required taxes, penalties, and interest.

Directs the director of taxation to prepare the necessary forms to satisfy the requirements of this act and may require a nonresident transferor to furnish information to ascertain the person's compliance.

Amends HRS section 235-68(d)(1) to clarify that a transferor who claims residency based on a business in Hawaii is not a resident if the business: (1) is not organized under the laws of the state; (2) does not maintain and staff a permanent office in the state; and (3) does not have any business activities in the state provided that the mere holding of real property in the state for investment purposes does not constitute a business activity.

EFFECTIVE DATE: Tax years beginning after December 31, 2009

STAFF COMMENTS: The proposed measure would ensure that all taxes are paid on the sale of real property by nonresidents of the state. This measure would require a nonresident transferor of real property to submit a tax clearance to the bureau of conveyances that all taxes, penalties, and interest owed to the state have been paid prior to the recordation of any transfer of title by the bureau.

While it is not unreasonable to require a nonresident seller of real property to secure a tax clearance from the department of taxation before the transfer is recorded, it should be remembered that the taxes owed on such a sale may not be due until the following year and, therefore, the nonresident would be compliant as the date of the transaction. If the intent is to insure the payment of the taxes on this transfer, then proof of the provisions of HARPTA (HRS 235-68) which requires the purchaser to withhold 5% of the sales price on a purchase from a nonresident owner should also be submitted.

Digested 2/9/10

Hawai'i Association of REALTORS®
www.hawaiirealtors.com

The REALTOR® Building
1136 12th Avenue, Suite 220
Honolulu, Hawaii 96816

Phone: (808) 733-7060
Fax: (808) 737-4977
Neighbor Islands: (888) 737-9070
Email: har@hawaiirealtors.com

February 9, 2010

The Honorable Marcus R. Oshiro, Chair
House Committee on Finance
State Capitol, Room 308
Honolulu, Hawaii 96813

RE: H.B. 1922 Relating to Taxation

HEARING: Wednesday, February 10, 2010 at 2:00 p.m.

Aloha Chair Oshiro, Vice Chair Lee and Members of the Committee:

I am Myoung Oh, Government Affairs Director, here to testify on behalf of the Hawai'i Association of REALTORS® ("HAR"), the voice of real estate in Hawai'i, and its 8,800 members in Hawai'i. HAR **submits comments** on H.B. 1922 which requires a nonresident seller of real property located in Hawai'i to furnish to the Bureau of Conveyances a tax clearance certificate issued from the Department of Taxation that certifies that the seller has paid all general excise, transient accommodations, and income taxes as a condition to recording a change in title on the real property.

HAR notes that the method of requiring all out-of-state sellers to acquire a tax clearance prior to recording a change in title may have a significant impact on real estate transactions involving non-resident sellers. The requirement to furnish a tax clearance certificate and the increase in the volume of tax clearances to be processed by DoTax could result in delays in: recording a deed, releasing sales proceeds from escrow, and the ability to close on a transaction.

If the Committee is inclined to pass this measure, HAR respectfully requests an effective date of November 1, 2010 be inserted, to review and revise the Purchase Contract and educate broker firms on potential internal office policy changes in dealing with non-resident seller clients.

HAR looks forward to working with our state lawmakers in building better communities by supporting quality growth, seeking sustainable economies and housing opportunities, embracing the cultural and environmental qualities we cherish, and protecting the rights of property owners.

Mahalo for the opportunity to testify.

Title Guaranty of Hawaii, Inc.

235 QUEEN STREET, HONOLULU, HI 96813 • P.O. BOX 3084, HONOLULU, HI 96802

LEGAL DEPARTMENT Phone (808) 533-5842 Fax (808) 521-0287 email: lhirano@tghawaii.com

February 9, 2010

Via Email: http://www.capitol.hawaii.gov/emailtestimony

The Honorable Marcus R. Oshiro, Chair
The Honorable Marilyn B. Lee, Vice Chair
Members Of The House Committee On Finance
415 South Beretania Street, Room 308
Honolulu, Hawaii 96813

Re: House Bill 1922 Relating to Taxation
Hearing Date: Wednesday, February 10, 2010
Hearing Time: 2:00 p.m.

Dear Representatives Oshiro and Lee, and Members of the House Committee on Finance:

I am writing on behalf of Title Guaranty of Hawaii, Inc. and Title Guaranty Escrow Services, Inc. We respectfully oppose the adoption of House Bill 1922 Relating to Taxation. While we support the philosophy of making sure that valid taxes are collected, the mechanism suggested by this Bill will create confusion and undue burden on real estate transactions.

The Bill requires that every nonresident transferor of real property submit a tax clearance certificate to the bureau of conveyances before recording any transfer of title of real property. The bureau of conveyances, however, is not in a position to determine whether a particular transferor is a resident or a non-resident and it is not well-situated to maintain an index of all of the tax clearance certificates. The added requirement of obtaining a tax clearance certificate will also delay and add expense to the closing of a real estate transaction at a time when transactions should be encouraged, not hindered.

While we are sure the Bill is well-intentioned, its passage will create confusion, delay and additional expense for the bureau of conveyances and for persons dealing with real property in this State. We respectfully urge the Committee to decline to pass this Bill.

Thank you very much for your consideration and attention to this matter.

Sincerely,

Lorrin Hirano
Legal Counsel

ARDA
American Resort Development Association
c/o PMCI Hawaii 84 N. King Street Honolulu, HI 96817 (808) 536-5688

February 10, 2010

TO: House Finance Committee
Representative Marcus Oshiro, Chair
Representative Marilyn B. Lee, Vice Chair

FROM: Ed Thompson
ARDA-Hawaii

DATE: Wednesday, February 10, 2010
Conference Room 308
2:00 p.m.

RE: **HB 1922, RELATING TO TAXATION**

Chair Oshiro and Members of the Committee:

ARDA-Hawaii is the local chapter of the national timeshare trade association. Hawaii's timeshare industry currently accounts for ten percent of the State's lodging inventory with 7,700 timeshare units. Timeshare has had consistent occupancy rates, even during the current tough economic times. This has made our industry a vital partner and a diverse component of the visitor industry in Hawaii.

A vast majority of people who own timeshare in Hawaii live outside of the state. When an owner decides to sell their timeshare interest, it is almost always sold at a loss, and there is no gain to report to the State. Other common timeshare transactions, outside of the resale market, are property exchanges where the timeshare owner is "upgrading" their current timeshare interest by purchasing a more expensive unit, (upon which taxes will be paid), and foreclosures, where a timeshare owner who is in default of the terms of the mortgage agreement wishes to provide the developer or association with a deed in lieu of foreclosure. In these cases, there is no taxable gain by the timeshare owner as they are either spending more money on the upgraded interest of their original timeshare or they are simply deeding over their timeshare interest to the developer for no monetary gain. In such cases, no revenue is owed to the State because there is no taxable gain by the consumer.

Given these facts, the additional filing requirements provided in HB1922 would appear to be unnecessary and would create a flood of paper work for the State that would result in additional costs and expense with no corresponding revenue from the timeshare owner. We ask the committee to consider amending HB1922 to include provisions in HB2362. The proposed changes in HB2362 are intended to balance the needs of the State with the likely impact from a transaction from which no tax is owed, as in the case of a sale at a loss or by virtue of a creditor acquiring the property due to a failure of a borrower from paying on a mortgage. We would be willing to work with the committee to draft the appropriate language to address these concerns.

Thank you for allowing me to offer testimony on this measure.

HOUSE COMMITTEE ON FINANCE

February 10, 2010

House Bill 1922 Relating to Taxation

Chair Oshiro and members of the House Committee on Finance, I am Rick Tsujimura, representing Marriott Vacation Club International (Marriott).

Marriott requests amendments to House Bill 1922 Relating to Taxation, by inserting the appropriate contents of House Bill 2362 or Senate Bill 2887, SD 1 to House Bill 1922. Both bills provide language which states that in the case of a foreclosure, a deed in lieu of foreclosure, or in a situation wherein real property is acquired in Hawaii that is worth more than the real property in Hawaii for which it is exchanged, no withholding under Chapter 235 is required. Both bills also provide relief from tax liability if the department of taxation has collected an amount equal to or exceeding the tax liability. Both bills also include a "*de minimus* exemption" as allowed in several other states, notably California.

We request that subsection (f) be amended as follows:

(f) No person shall be required to deduct and withhold any amount under subsection (b) [~~if~~]:

(1) If one or more individual transferors furnishes to the transferee an affidavit by the transferor stating the transferor's taxpayer identification number, that for the year preceding the date of the transfer the property has been used by the transferor as a principal residence, and that the amount realized for the property does not exceed $300,000[~~.~~];

(2) If the transferee acquires the real property pursuant to foreclosure or a deed in lieu of foreclosure;

(3) If the amount realized by the transferor includes real property located in Hawaii the fair market value of which is equal to or greater than the fair market value of the real property acquired by the transferee; or

(4) If the amount realized on the disposition of real property that is a time share interest, as defined in section 514E-1, does not exceed $100,000.

We further request the addition of a new sub-section (h) be inserted to read as follows:

(h) Any person held liable for the tax under subsection (b) due to a failure to deduct and withhold on the disposition of real property as required, shall be relieved of that liability to the extent that the department has collected an amount of tax equal to the transferor's

tax liability related to the disposition. This subsection shall not relieve any person from liability for interest or any penalties otherwise applicable in respect of any failure to deduct and withhold.

Thank you for the opportunity to present this testimony.