

**SB 1230**



March 3, 2009

**LATE**

**The Honorable Donna Mercado Kim, Chair**  
Senate Committee on Ways and Means  
State Capitol, Room 211  
Honolulu, Hawaii 96813

**RE: S.B. 1230, S.D. 1, Relating to Taxation**

**HEARING DATE:** Wednesday, March 4, 2009 at 9:30 a.m.

Aloha Chair Kim and Members of the Committee on Ways and Means.

I am Craig Hirai, a member of the Subcommittee on Taxation and Finance of the Government Affairs Committee of the Hawai'i Association of REALTORS® ("HAR"), here to testify on behalf of the HAR and its 9,600 members in Hawai'i. HAR **strongly opposes S.B. 1230, S.D.1, Relating to Taxation**, which authorizes a conveyance tax on the transfer of interests in real property holding companies.

While the HAR understands the State's need for new sources of revenue in these tough economic times, HAR believes that S.B. 1230, S.D.1, is unfair and inequitable and essentially unworkable for small businesses and investors.

For example, Section 2 of S.B. 1230, S.D.1, defines "real property holding company" as follows:

"Real property holding company" means any corporation, partnership, limited liability company, trust, estate, or other entity for which the fair market value of all of its real property interests equals or exceeds fifty per cent of the fair market value of all of its assets.

The definition does not limit the entity's real property holdings to those in Hawaii, and it is possible that under this definition a Hawaii limited liability company could only own real property on the Mainland and still be a "real property holding company" as could a Mainland limited liability company doing business in Hawaii temporarily that only owns real property on the Mainland.

Furthermore, the above definition of "real property holding company" includes limited liability companies that are often taxed as partnerships for federal and Hawaii income tax purposes. Because they are taxed as partnerships and limit their members' liability like corporations, limited liability companies tend to be an entity of choice for holding real property interests. Section 2 of S.B. 1230, S.D.1, however, includes a definition of "terminated partnership" which reads as follows and does not include limited liability companies.



"Terminated partnership" means a partnership for which no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership or for which fifty per cent or more of the total interest in partnership capital and profits is sold or exchanged within a twelve month period.

This definition may lead to some confusion under proposed HRS §247-3(20) which exempts from the Conveyance Tax and reads as follows:

(20) Any document or instrument that transfers an interest in a partnership (or limited liability company that is taxed as a partnership) that is a real property holding company if the partnership is not a terminated partnership immediately after the transfer.

Based on the definition of "terminated partnership" above, it may be possible to argue that the transfer of an interest in a partnership is exempt from the Conveyance Tax unless it is a "terminated partnership", but that the transfer of an interest in a limited liability company is always exempt from the tax since it cannot by definition be a "terminated partnership".

Furthermore, it is inequitable that under S.B. 1230, S.D.1, shares in a corporation that is a "real property holding company" are always subject to the Conveyance Tax no matter what percentage of ownership or control they represent, and that a change in ownership of a publicly traded corporation that may have significant real estate holdings in Hawaii is not subject to the Conveyance Tax.

HAR would also note that Section 2 of S.B. 1230, S.D.1, contains a definition of "fair market value" that reads as follows:

"Fair market value" means, for purposes of this chapter but not for the purpose of calculating the gain or loss from the disposition of realty or interest therein, the price on the date of a transfer or conveyance at which the asset would change hands between an unrelated willing buyer and willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of all relevant facts; reduced by the outstanding balance of any mortgage or other security interest in the asset that was incurred to acquire the asset or otherwise incurred in direct connection with the asset, such as a real property tax lien or debt incurred to improve or maintain the property.

HAR believes that under this definition the fair market value of a real property interest in Hawaii which is owned by a limited liability company may be reduced over time by a member's use of acquisition debt secured by a mortgage or other security interest on the real property interest.

Furthermore, if a member acquired 90% control of a limited liability company that is a "real property holding company", the member could merge it into a limited partnership Conveyance Tax free under HRS §247-3(15), and the limited partnership may then be able to



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distribute any real property interest Conveyance Tax free to the member under HRS §247-3(16).

HAR believes that there may be fairer and more equitable ways to tax the transfer or acquisition within any 12-month period of a controlling interest in any entity with an interest in real property located in Hawaii.

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.

# LATE

## Department of Taxation

### Position Summary

Senate Committee on Ways & Means/March 4, 2009

1230

Bill Number	Bill Title "Relating to..."	Position	Comments	Revenue Impact	Methodology
SB 1106 SD 1	TAXATION	Support Intent; Request Amendments Contained in SB 1230 SD 1	The Department suggests that the substance of the HARPTA amendments contained in SB 1230 SD 1 subsection (h) be adopted. The Department's provision requires the seller to obtain a tax clearance as to the specified tax matters.	Unknown revenue gains. This bill estimated a potential annual shortfall of \$1.3 million in withholding tax revenues by nonresident sellers of real property.	This bill estimated a potential annual shortfall of \$1.3 million in withholding tax revenues by nonresident sellers of real property. The requirement that nonresident sellers furnish a tax clearance to the bureau of conveyance will help eliminate that estimated shortfall from nonresident sellers of real property and may also increase other revenues due from TAT and GET. The Department will incur additional cost to process the tax clearance certificates for nonresident sellers.

SB 1230 SD 1	TAXATION	Support	The Department prefers the draft submitted to the Committee on Commerce & Consumer Protection under separate cover. This draft incorporated conforming language contained in the Internal Revenue Code.	Undetermined at this time.	The value of the transactions subject to this bill is unknown at this time. The increased conveyance tax revenues would be distributed as follows: 35 percent to the General Fund, 10 percent to the Land Conservation Fund, 30 percent to the Rental Housing Fund, and 25 percent to the Natural Area Reserve Fund
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