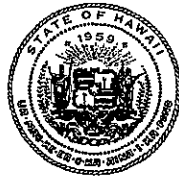


NEIL ABERCROMBIE
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DIRECTOR OF TAXATION

RANDOLF L. M. BALDEMOR
DEPUTY DIRECTOR

HOUSE COMMITTEE ON FINANCE

TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING HB 1180 RELATING TO TAXATION

TESTIFIER: FREDERICK D. PABLO, DIRECTOR OF TAXATION
(OR DESIGNEE)

COMMITTEE: FIN

DATE: FEBRUARY 25, 2011

TIME: 4PM

POSITION: CONCERNS

This bill amends the conveyance tax to capture the tax on the sale of stock in entities that own Hawaii real property.

NEW TAX TYPE -- The Department of Taxation (Department) is concerned that the complexity of these new provisions would be difficult to administer. Although technically part of the conveyance tax, this tax represents a new type of tax for the Department to collect. While the Department administers the conveyance tax, the Department does not collect the conveyance tax. Therefore, the Department's computer system would need to be updated to reflect this new law.

PROPORTION OF REAL PROPERTY AND INTENT OF SALE -- In addition, the Department is concerned that the new tax would apply to the sale of a controlling interest in an entity, even if the entity's assets were comprised mostly of property, other than real estate. For example, an operating business, such as a construction company, may own the real property upon which the company's headquarters is located, which could represent only a small fraction of the value of the entire business. If a controlling interest in the construction company is sold, the controlling interest transfer tax would be

triggered even though the primary purpose of the sale was to sell the construction business, not the real property.

REVENUE IMPACT—For the special funds, the revenue impact for this bill is approximately \$1.2 million of revenue per year in fiscal year 2012, and \$1.4 million in fiscal year 2013 and thereafter. For the general fund, the revenue impact is approximately \$0.8 million in fiscal year 2012 and \$0.6 million in fiscal year 2013 and thereafter.

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SUBJECT: CONVEYANCE, Transfer of a controlling interest

BILL NUMBER: HB 1180

INTRODUCED BY: Choy

BRIEF SUMMARY: Amends a new section to HRS chapter 247 to provide that the conveyance tax shall be applicable to the transfer or acquisition, or a series of transfers or acquisitions, including those combined with otherwise exempt transfers, by any person or entity, either acting alone or in concert, within any 12-month period, that result in the transfer of a controlling interest in an entity with an interest in real property located in this state for valuable consideration and which also results in the transfer of control or ownership of the real property located in this state.

In determining whether a controlling interest was transferred or acquired within a 12-month period, the date that the option agreement was executed shall be the date on which the transfer or acquisition of the controlling interest is deemed to occur. For all other purposes, the date upon which the option is exercised is the date of the transfer or acquisition of the controlling interest.

Stipulates that for the purposes of this section with regard to persons acting in concert: (1) all acquisitions of persons acting in concert shall be aggregated for the purpose of determining whether a transfer or acquisition of a controlling interest has taken place; (2) persons shall be considered as acting in concert when they have a relationship with each other such that one person influences or controls the actions of another through common ownership; (3) persons shall be considered to be acting in concert only when the unity with which the purchasers negotiate and consummate the transfer of ownership interests supports a finding that the persons are acting as a single entity; and (4) if acquisitions are completely independent and each purchaser purchases without regard to the identity of the other purchasers, then the acquisitions shall be considered separate acquisitions.

“Controlling interest” shall mean: (1) in the case of a corporation, either 50% or more of the total combined voting power of all classes of stock of the corporation entitled to vote, or 50% or more of the capital, profits, or beneficial interest in the voting stock of the corporation; and (2) in the case of a partnership, association, trust, or other entity, 50% or more of the capital, profits, or beneficial interest in the partnership, trust, or other entity.

Directs the director of taxation to adopt rules pursuant to HRS chapter 91 to implement this section, including rules for determining whether persons are acting in concert for the purpose of transferring or acquiring a controlling interest.

Adds a new section to HRS chapter 247 to provide that the conveyance tax imposed by HRS section 247-1 shall apply to the following at the lowest rate regardless of the value of the real property: (1) any document or instrument conveying real property, or any interest therein, from an entity that is a party to a merger or consolidation under HRS chapters 414, 414D, 415A, 421, 421C, 425, 425E, or 428 to the

surviving or new entity; (2) any document or instrument conveying real property, or any interest therein, from a dissolving limited partnership to its corporate general partner that owns, directly or indirectly, at least a ninety per cent interest in the partnership, determined by applying section 318 (with respect to constructive ownership of stock) of the federal Internal Revenue Code of 1986, as amended, to the constructive ownership of interests in the partnership; (3) any document or instrument conveying real property to any nonprofit or for-profit organization that has been certified by the Hawaii housing finance and development corporation for low-income housing development; and (4) any document or instrument conveying real property, or any interest therein, to or from a wholly-owned corporation or limited liability company.

Makes conforming amendments to HRS section 247-1 and HRS section 247-3.

EFFECTIVE DATE: July 1, 2011

STAFF COMMENTS: The proposed measure would subject to the conveyance tax rates "complex transactions" involving the transfer of real property to ensure that the transactions are taxed, even though they are not currently 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 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 while the measure proposes that the conveyance tax at the lowest rate shall be imposed on these transfers, there is not doubt that this policy may be amended and the rate will mushroom in a few years as the legislature may target these transfers as another way to raise additional revenue.

Unfortunately, the imposition of the conveyance tax on these transfers may 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.

While this proposal tries to address what looks like a sale of an entity or organization that has as part of its portfolio real property in Hawaii, there are other ways of transferring a company and the controlling interest of such an entity without the appearance that the organization or entity is being sold or transferred. This proposal would increase the cost of affordable housing that is developed by a partnership or joint venture of a for-profit entity and a not-for-profit entity. The partnership may have

been created out of necessity where a for-profit developer brings the expertise and the ability to market various government subsidies while the nonprofit partner is able to secure the public subsidies like foundation and federal grants or in the case of low-income housing tax credits which the for-profit can then market to investors to raise the necessary capital to construct the project. When the compliance period expires, the for-profit may want to exit the partnership transferring its ownership to the nonprofit. Under this proposal there would be the imposition of the conveyance tax which then would add to the cost of the nonprofit taking on the for-profit's title to the real property. The bottom line is that this added cost will be passed on to the low-income tenants renting the affordable housing. This appears to be one of the unintended consequences of this proposal.

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February 24, 2011

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

RE: H.B. 1180, Relating to Taxation

HEARING: Friday, February 25, 2011 at 4:00 p.m.

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

I am Craig Hirai, chair of the Subcommittee on Affordable Housing, here to testify on behalf of the Hawaii Association of REALTORS® ("HAR"), the voice of real estate in Hawaii, and its 8,500 members. HAR would like to make the following **comments** with respect to H.B. 1180, Relating to Taxation, which: (a) imposes Conveyance Tax on the transfer of a controlling interest of an entity with an interest in Hawaii real property; and (b) imposes the Conveyance Tax on certain transfers of real property between related entities at the lowest tax rate. The purpose of H.B. 1180 is to apply the Conveyance Tax to transfers of entity ownership when the transfer of entity ownership is essentially equivalent to the sale of an interest in Hawaii real property.

HAR believes that the transfer of control of a business entity is comparable to the sale of an interest in the real property held by the entity. HAR further believes that all transfers of possession or use of real property in Hawaii should be subject to the same Conveyance Tax obligations and that the burden of the Hawaii Conveyance Tax currently falls primarily on smaller Hawaii business and property owners, and Hawaii homeowners who generally convey title to real property itself and not controlling interests in entities that own Hawaii real property.

HAR would note favorably that: (i) the transfer of a controlling interest under H.B. 1180 is subject to Conveyance Tax receipts of which among other things supports the Rental Housing Trust Fund; and (ii) the conveyance of real property interests between certain controlling and controlled entities under H.B. 1180 will only be subject to the Conveyance Tax at the lowest rate.

Mahalo for the opportunity to testify.



Testimony to the House Committee on Finance
Friday, February 25, 2011 at 4:00 p.m.
Conference Room 308, State Capitol
Agenda #6

RE: HOUSE BILL NO. 1180 RELATING TO TAXATION

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

The Chamber of Commerce of Hawaii ("Chamber") opposes HB 1180 relating to Taxation.

The Chamber is the largest business organization in Hawaii, representing more than 1,100 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of its members, which employ more than 200,000 individuals, to improve the state's economic climate and to foster positive action on issues of common concern.

States that impose conveyance taxes on real property transfers generally impose them in one of two ways: either they tax changes in title to real property, or they tax changes in beneficial ownership of real property. Hawaii, under current law, is an example of a state that taxes changes in title to real property. Connecticut is an example of a state that taxes changes in beneficial ownership of real property. The proposed bill, however, would go far beyond other states by taxing changes in beneficial ownership while continuing to tax changes in title. We are concerned that such a tax regime would result in double-taxation of many legitimate business transactions.

For example, groups of wholly-owned entities often reorganize themselves, by merger or otherwise, in order to streamline their operations. The proposed bill would appear to tax these types of transactions, even if they involve no change in either title or beneficial ownership of the underlying real property (and even though conveyance tax was paid when the group acquired the property, and will be paid again when the group sells the property). As another example, businesses often engage in "reverse" like-kind exchanges, in which property is conveyed by a third-party to a single-member LLC for the taxpayer's benefit, and then ownership of the LLC is transferred to the taxpayer. The proposed bill would appear to tax these transactions twice, even though they involve only one change in title and beneficial ownership of the property. Results such as these would create unreasonable inefficiencies for businesses, and discourage them from transacting business in Hawaii.

If the Legislature is nevertheless inclined to pass the proposed bill, we suggest that it be amended to provide, like the Connecticut statute (upon which the proposed bill appears to be largely based) that: "the conveyance tax shall not apply to transfers or conveyances to effectuate a mere change of identity or form of ownership or organization, where there is no change in beneficial ownership." We would also welcome the opportunity to discuss the proposed bill and Hawaii's conveyance tax system more generally, to ensure that it is fair for all businesses and other property owners.



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**HB 1180
RELATING TO TAXATION**

**PAUL T. OSHIRO
MANAGER – GOVERNMENT RELATIONS
ALEXANDER & BALDWIN, INC.**

FEBRUARY 25, 2011

Chair Marcus Oshiro and Members of the House Committee on Finance:

I am Paul Oshiro, testifying on behalf of Alexander & Baldwin, Inc. (A&B) on HB 1180, "A BILL FOR AN ACT RELATING TO TAXATION."

The purpose of this bill is to impose the conveyance tax on the transfer of a controlling interest of an entity with an interest in real property.

We understand that as presently drafted, this new tax may be imposed on a transfer of interest within a wholly owned entity, which includes transfers from one member of an affiliated group to another member of that same group. These transactions, which do not result in any change in the beneficial ownership interest in an entity, includes transfers between entities that are members of the same affiliated group or transfers between a single member LLC and its member. We respectfully request your consideration to incorporate amendments into Section 2, 247-A(a) of this bill to exclude from its applicability, transfer of interests between entities wholly owned by the same common ownership that result in no change in beneficial ownership. We have attached proposed amended language for your consideration:

SECTION 2. Chapter 247, Hawaii Revised Statutes, is amended by adding two new sections to be appropriately designated and to read as follows:

"§247-A Transfer of a controlling interest; applicability. (a) Notwithstanding any provision to the contrary, the tax imposed by section 247-1 shall apply to the transfer or acquisition, or a series of transfers or acquisitions, including those combined with otherwise exempt transfers, by any person or entity, either acting alone or in concert, within any twelve-month period, that result in the transfer of a controlling interest in an entity with an interest in real property located in this State for valuable consideration and which also results in the transfer of control or ownership of the real property located in this State; provided that this section shall not apply to any transfer or acquisition that consists of a mere change in identity or form of ownership of an entity where there is no change in the beneficial ownership, including, but not limited to, transfers to an entity wholly owned, directly or indirectly, by the same common ownership as the transferor."

Thank you for the opportunity to testify.