

**HB 680 PROPOSED SD1
RELATING TO TAXATION**

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

MARCH 20, 2013

Chair Ige and Members of the Senate Committee on Ways & Means:

I am Paul Oshiro, testifying on behalf of Alexander & Baldwin, Inc. (A&B) on HB 680 PROPOSED SD1, “A BILL FOR AN ACT RELATING TO TAXATION.”

The purpose of this bill is to impose the conveyance tax on the conveyance of a controlling interest of an entity with an interest in real property in the State. We understand that the amendment that was recently incorporated into the Senate companion bill (SB 97 SD2), to exclude from the conveyance tax transfers of controlling interest between members of an existing, established entity, has not been included in the proposed SD1 of HB 680. We respectfully request your consideration to incorporate this amendment into this bill.

Individual companies or parties often form new business entities to pool together their various interests, expertise and resources. For example, knowledge in the areas of financing, sales and marketing, planning, and branding are some of the skills that one party may bring to a business partnership, while another party may have expertise in operating the business assets. Through their jointly owned business entity, they are able to efficiently pool their knowledge, resources, and expertise to more effectively pursue a business plan.

We believe the proposed amendment, excluding the imposition of the conveyance tax on internal transfers of controlling interests between members of an existing, established entity, will support the continued use of these types of entities and collaborations as a means of bringing together the knowledge and expertise necessary to pursue new business opportunities in Hawaii.

We respectfully request your consideration to incorporate amendments into this bill to exclude from its applicability the transfer of controlling interests between members of an existing, established entity. We have attached the following amended language to Section 4 of this bill for your consideration:

SECTION 4. Section 247-3, Hawaii Revised Statutes, is amended to read as follows:

"**§247-3 Exemptions.** The tax imposed by section 247-1 shall not apply to~~+~~ the following conveyances:

- (1) Any [~~document or instrument~~] conveyance that is executed prior to January 1, 1967;
- (2) Any [~~document or instrument~~] conveyance that is given to secure a debt or obligation;
- (3) Any [~~document or instrument~~] conveyance that only confirms or corrects a deed, lease, sublease, assignment, transfer, or conveyance previously recorded or filed;
- (4) Any [~~document or instrument~~] conveyance between husband and wife, reciprocal beneficiaries, or parent and child, in which only a nominal consideration is paid;
- (5) Any [~~document or instrument~~] conveyance in which there is a consideration of \$100 or less paid or to be paid;
- (6) Any [~~document or instrument conveying real property that is~~] conveyance executed pursuant to an agreement of sale, and where applicable, any assignment of the agreement of sale, or assignments thereof; provided that the taxes under this chapter have been fully paid upon the agreement of sale, and where applicable, upon such assignment or assignments of agreements of sale;
- (7) Any [~~deed, lease, sublease, assignment of lease, agreement of sale, assignment of agreement of sale, instrument or writing~~] conveyance in which the United

States or any agency or instrumentality thereof or the State or any agency, instrumentality, or governmental or political subdivision thereof are the only parties thereto;

- (8) Any [~~document or instrument~~] conveyance executed pursuant to a tax sale conducted by the United States or any agency or instrumentality thereof or the State or any agency, instrumentality, or governmental or political subdivision thereof for delinquent taxes or assessments;
- (9) Any [~~document or instrument conveying real property~~] conveyance to the United States or any agency or instrumentality thereof or the State or any agency, instrumentality, or governmental or political subdivision thereof pursuant to the threat of the exercise or the exercise of the power of eminent domain;
- (10) Any [~~document or instrument~~] conveyance that solely conveys or grants an easement or easements;
- (11) Any [~~document or instrument~~] conveyance whereby owners partition their real property, whether by mutual agreement or judicial action; provided that the value of each owner's interest in the real property after partition is equal in value to that owner's interest before partition;
- (12) Any [~~document or instrument~~] conveyance between marital partners or reciprocal beneficiaries who are parties to a divorce action or termination of reciprocal beneficiary relationship that is executed pursuant to an order of the court in the divorce action or termination of reciprocal beneficiary relationship;
- (13) Any [~~document or instrument conveying real property~~] conveyance from a testamentary trust to a beneficiary under the trust;
- (14) Any [~~document or instrument conveying real property~~] conveyance from a grantor to the grantor's revocable living trust, or from a grantor's revocable living trust to the grantor as beneficiary of the trust;
- [~~(15)~~] Any ~~document or instrument conveying real property, or any interest therein, from an entity that is a party to a merger or consolidation under chapter 414, 414D, 415A, 421, 421C, 425, 425E, or 428 to the surviving or new entity;~~
- ~~(16)~~ 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; and~~

~~[(17)]~~ (15) Any ~~[document or instrument]~~ conveyance that conforms to the transfer on death deed as authorized under chapter 527[-]

(16) Any conveyance to effectuate a mere change of identity or form of ownership or organization where there is no change in beneficial ownership, other than a conveyance to a cooperative housing corporation, as defined in section 421I-1, or limited-equity housing cooperative, as defined in section 421H-1, of the real property comprising the cooperative dwelling or dwellings; and

(17) Any conveyance that consists solely of a transfer or acquisition of a controlling interest in an entity with an interest in real property between persons with ownership interests in such entity for a minimum of three years immediately preceding the transfer."

Thank you for the opportunity to testify.

BIA-HAWAII

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Testimony to the Senate Committee on Ways and Means

Wednesday, March 20, 2013

10:00 a.m.

State Capitol - Conference Room 211

RE: **H.B. 680, H.D. 2, Proposed S.D.1, RELATING TO TAXATION**

Dear Chair Ige, Vice-Chair Kidani, and members of the committee:

My name is Gladys Marrone, Director of Government Relations for the Building Industry Association of Hawaii (BIA-Hawaii), the voice of the construction industry. BIA-Hawaii promotes its members through advocacy and education, and provides community outreach programs to enhance the quality of life for the people of Hawaii. BIA-Hawaii is a not-for-profit professional trade organization, chartered in 1955, and affiliated with the National Association of Home Builders.

BIA-Hawaii **opposes** H.B 680 H.D. 2, Proposed S.D.1. The bill proposes amendments to Chapter 247 HRS that would impose a conveyance tax on the conveyance of a controlling interest of an entity with an interest in real property in the State.

This bill would amend HRS § 247 by defining "Conveyance" as the transfer or transfers of any interest in real property by any method, including but not limited to sale, exchange, assignment, surrender, mortgage foreclosure, transfer in lieu of foreclosure, option, trust indenture, taking by eminent domain, conveyance upon liquidation or by a receiver, or transfer or acquisition of a controlling interest in any entity with an interest in real property. Conveyance of an interest in real property shall include the creation of a lease-hold or sublease.

The purpose is an attempt to close what is perceived to be a "loop-hole" in the current law in which the conveyance of an entire business or entity with real estate holdings is not presently subject to the conveyance tax. However, it appears that the real issue is not the imposition of the conveyance tax on these types of business transactions, but to increase the funds raised through the conveyance tax for purposes unrelated to the documentation of the real estate transaction.

The conveyance tax was created to cover the administrative costs of recording real estate transactions, such as those performed by the Bureau of Conveyance. With the recent amendments to the statutes, however, the conveyance tax is deposited into the general fund with the following allocations:

1. Ten per cent shall be paid into the **Land Conservation Fund** established pursuant to section 173A-5;
2. Twenty-five per cent from July 1, 2009, until June 30, 2012, and thirty per cent in each fiscal year thereafter shall be paid into the **Rental Housing Trust Fund** established by section 201H-202; and
3. Twenty per cent from July 1, 2009, until June 30, 2012, and twenty-five per cent in each fiscal year thereafter shall be paid into the **Natural Area Reserve Fund** established by section 195-9; provided that the funds paid into the natural area reserve fund shall be annually disbursed by the department of land and natural resources in the following priority:

- a. To natural area partnership and forest stewardship programs after joint consultation with the forest stewardship committee and the natural area reserves system commission;
- b. Projects undertaken in accordance with watershed management plans pursuant to section 171-58 or watershed management plans negotiated with private landowners, and management of the natural area reserves system pursuant to section 195-3; and
- c. The youth conservation corps established under chapter 193.

We are deeply troubled by the manner in which the conveyance tax has been used to generate revenues for unrelated purposes. There is no rational nexus between the real estate transactions that are being taxed at conveyance and the uses identified in Chapter 247, HRS, as the beneficiaries of the tax. We do not believe that the conveyance tax is being used in an appropriate manner. We believe the Auditor of the State of Hawaii had similar findings.

In July 2012 the Auditor of the State of Hawaii prepared a report entitled, "Study of the Transfer of Non-general Funds to the General Fund," Report No. 12-04. On page 26 of the report, the Auditor found:

"In 2002, the Legislature set the criteria for determining whether special or revolving funds should be established or continued through Act 178, SLH 2002 and codified in Sections 37-52.3 and 37-52.4, HRS. To justify the creation and continuance, the Legislature must ensure that a special or revolving fund:

- *serves the purpose for which it was originally established;*
- *reflects a clear nexus between the benefits sought and charges made upon the users or beneficiaries of the program, as opposed to serving primarily as a means to provide the program or users with an automatic means of support that is removed from the normal budget and appropriation process; . . ."*

The Report also contains the following findings on two of the funds receiving funding through the Conveyance Tax (pages 29 and 30):

"Another example of a fund that has no benefit-user charge linkage is the Department of Land and Natural Resources' Land Conservation Fund. Under Section 247-7(1), HRS, the Legislature authorized funding from 10 percent of the state real property conveyance tax receipts. However, the purpose of the fund is to conserve and protect lands having value as a resource to the state through either acquisition of property or through permanent conservation easements to protect resource values. Hence, beneficiaries of the conservation and preservation programs are state residents as a whole, and as such the programs should be supported by funding from a broader tax because of the broad public benefit. Although the Legislature determined the conveyance tax an appropriate means of funding conservation of natural resources, the Land Conservation Fund established under Section 247-7(1), HRS, the program should draw support from the general fund rather than a tax charged on individuals and companies involved in real estate transactions."

"Likewise, the Natural Area Reserve Fund has minimal linkage between the benefits and the fund revenue, which comes from conveyance taxes paid on real estate transactions. The fund supports programs such as the Natural Area Partnership and Forest Stewardship programs, projects undertaken in accordance with watershed management plans, and the Youth Conservation Corps. Individuals that pay this tax may benefit from the Natural Area Reserves program, but so do other Hawai'i residents and visitors to the state."

Finally, we question whether this specific type of legislation would even be introduced if the conveyance tax were limited to its original purpose of recording real estate transactions.

We do not believe that H.B. 680, H.D.2, proposed S.D.1 utilizes the conveyance tax in an appropriate manner. The proposed bill only exacerbates the current problem.

Thank you for the opportunity to express our views on this matter.



CATHOLIC CHARITIES HAWAII

TESTIMONY IN SUPPORT OF HB 680 SD1: RELATING TO TAXATION

TO: Senator David Y. Ige, Chair; Senator Michelle N. Kidani, Vice Chair, and Members, Committee on Ways and Means

FROM: Betty Lou Larson, Legislative Liaison, Catholic Charities Hawaii

Hearing: Wednesday, 2/20/13; 2:00 PM; CR 308

Chair Ige, Vice Chair Kidani, and Members, Committee on Ways and Means:

Thank you for the opportunity to testify **in strong support** of HB 680 SD1, regarding applying the conveyance tax to the sale, transfer or exchange of stock, whose assets include realty located in Hawaii. I am Betty Lou Larson, Legislative Liaison for Catholic Charities Hawaii.

When Lanai was sold, no conveyance tax was paid. Yet if a house or a business is sold, the conveyance tax is paid. This bill would close a loophole in the conveyance tax law and provide additional needed funds for critical state needs, such as affordable housing, land preservation and watershed protection which receive appropriations from the conveyance tax proceeds

Immediate additional resources are needed for the State to address homelessness and the rental housing crisis for our State's residents. Therefore, we urge you to **increase the percentage of the conveyance tax allocated to the Rental Housing Trust Fund to 50%**. In Section 247-7 of the law, Disposition of taxes: change: Thirty percent to **fifty percent** shall be paid into the rental housing trust fund established by section 201H-202.

Catholic Charities Hawaii receives hundreds of calls each month from families that need affordable housing. Hawaii ranks 3rd among the states for the rate of homelessness. The Hawaii Housing Planning Study of 2011 found that an estimated 13,000 rental units need to be built by 2016. To build these 13,000 affordable units, additional resources are required for the Rental Housing Trust Fund, which receives conveyance tax proceeds. The Trust Fund has created 4,250 rental units. In FY 12, it received \$37 million in project requests, yet was only able to commit funds to 4 out of the 9 project applications due to limited resources.

Other Proposed Amendments. We also support the following amendments to this bill that were part of SB 97 SD2 as passed by the Senate and that are reasonable tax limitations or exemptions for stock transfers between wholly owned entities, related partners, subsidiaries, or affordable housing projects that support true business partnerships while preventing the formation of entities just to avoid the conveyance tax.

At p.9, §247-C, insert the following amendment: “(3) Any document or instrument conveying real property, or any interest therein, to or from a wholly owned corporation or wholly owned limited liability company of the grantor or grantee, respectively.”

At p. 20, §247-3, insert the following amendment: “(16) Any conveyance from a limited partner to a general partner of a limited partnership that owns an affordable rental housing project for which

low-income housing tax credits have been issued under section 235-110.8 or 241-4.7 or section 42 of the Internal Revenue Code of 1986, as amended; and

“(17) Any conveyance that consists solely of a change in controlling interest in an entity holding an interest in realty between persons with ownership interests in such entity for a minimum of three years immediately preceding the transfer ~~Any conveyance to effectuate a mere change of identity of form of ownership or organization where there is no change in beneficial ownership, other than a conveyance to a cooperative housing corporation as defined in section 421H-1 or limited equity housing cooperative defined in section 421H-1, of the real property comprising the cooperative dwelling or dwellings.~~”

At p. 27, §247-6, insert the following amendment: “(11) For any conveyance exempted under section 247-6(16), the grantor and the grantee shall file a certificate declaring that the conveyance is from a limited partner to a general partner of a limited partnership that owns an affordable rental housing project for which low-income housing tax credits have been issued under section 235-110.8 or 241-4.7 or section 42 of the Internal Revenue Code of 1986, as amended ~~effectuates a mere change of identity or form of ownership or organization where this is no change in beneficial ownership.~~”

“(12) For any conveyance exempted under section 247-6 (17), the grantor and the grantee shall file a certificate declaring that the conveyance consists solely of a change in controlling interest in an entity holding an interest in realty between persons with ownership interests in such entity for a minimum of three years immediately preceding the transfer.”

Additional resources to the Rental Housing Trust Fund would result in projects being immediately funded to move ahead for construction of these much needed units for families, the elderly, and residents of Hawaii who need affordable rentals.

We urge your support for HB 680 SD1 to close this tax loophole and tax the value of the real estate in a fair and equitable manner. We also urge you to **increase the allocation to the Rental Housing Trust Fund to 50% of the conveyance tax.**

Thank you for considering HB 680 SD1 and its impact on housing and land protection. We appreciate your hard work to find resources to create new affordable rental housing which will leave a legacy for years to come for our State.



March 18, 2013

Senator David Y. Ige, Chair
Senator Michelle N. Kidani, Vice Chair
Senate Committee on Ways and Means

Testimony in Strong Opposition to HB 680, SD 1, Relating to Conveyance Tax (Controlling Interest Transfer).

Wednesday, March 20, 2013, 10:00 a.m., in Conference Room 211

The Land Use Research Foundation of Hawaii (LURF) is a private, non-profit research and trade association whose members include major Hawaii landowners, developers and a utility company. LURF's mission is to advocate for reasonable, rational and equitable land use planning, legislation and regulations that encourage well-planned economic growth and development, while safeguarding Hawaii's significant natural and cultural resources, and public health and safety.

HB 680, SD 1. This bill proposes to impose conveyance tax on the transfer or conveyance of a controlling interest of an entity with an interest in realty in the State.

LURF's Position. LURF acknowledges the stated intent of this bill, which is to apply the conveyance tax to transfers of entity ownership when such transfer is essentially equivalent to the sale of an interest in real property. However, based on the following reasons and considerations, LURF opposes HB 680, SD 1, and must request that this bill be held in Committee.

The proposed imposition of the conveyance tax on transfers of controlling interests in entities is inappropriate and improper given that:

- 1. The Hawaii Conveyance Tax was never intended as a revenue-generating tax.** Hawaii Revised Statutes ("HRS"), Chapter 247 (Conveyance Tax), was purposefully enacted in 1966 to provide the State Department of Taxation ("DoTax") with informational data for the determination of market value of properties transferred, and to assist the DoTax in establishing real property assessed values. In short, the sole intent of the conveyance tax was originally to cover the administrative costs of collecting and assessing said informational data, which necessarily entails the recording of real estate transactions, as performed by the Bureau of Conveyances. As such, the conveyance tax should not be utilized as a vehicle to generate revenue, especially for non-conveyance tax-related funds and programs.

2. Special, revolving, and trust funds should be used only for their specified purpose, and may not be applied to other programs.

Since the enactment of HRS Chapter 247, however, the State Legislature has proposed, and has successfully implemented changes to the law 1) to allow application of conveyance tax revenue to a number of non-conveyance type uses (land conservation fund; rental housing trust fund; and natural area reserve fund) to the point where there is no longer any clear nexus between the benefits sought by the original Act and the charges now proposed to be levied upon property-holding entities transferring ownership; and 2) also to increase the tax rates to the point where said revenues now appear to far exceed the initially stated purpose of the Act.

a. Pending legislation. HB 504, HD1 and SB 190, SD1, currently pending before this Legislature, directly address this very issue and reinforce the requirement that special and revolving funds must reflect a clear link between the program funded and the source of revenue. The principles underlying HB 504, HD1 and SB 190, SD1 are clear, and the measures, whether or not ultimately approved, nevertheless settle without question, the fact that special, revolving, and trust funds must serve the purpose for which they are established; must reflect a clear nexus between the benefits sought and charges made upon the program users or beneficiaries; or a clear link between the program and the sources of revenue. As applied to this case, HB 504, HD1 and SB 190, SD1, thus make it unequivocally clear that it is improper to channel conveyance tax revenue obtained through assessments targeted solely at landowning entities to special, revolving, or trust funds/programs with no nexus or clear link to the sources of revenue.

b. Alternative methods exist to secure revenues for special, revolving, and trust funds. In lieu of improperly imposing the conveyance tax to transfers of entity ownership involving the sale of an interest in land, proponents of this bill seeking to increase revenue for certain special funds or programs should look to other possible legitimate means to do so, including the following:

- i. Current and proposed funding support through county board of water supply charges;
- ii. Funding through voluntary donations by rental car lessors or hotel room guests (*See* HB 760, HD1, SD1 (which requires lessors of rental motor vehicles to include an option to the lessee in the motor vehicle agreement to contribute a sum to the Department of Land and Natural Resources for the preservation of the environment);and
- iii. Voluntary contribution programs such as an income tax refund check-off box (*See* HB 571 (which proposed to permit all Hawaii taxpayers to voluntarily designate a specified amount of the taxpayer's income tax refund to be deposited into the State's Early Learning Trust Fund)).

Given the "clear nexus" and "clear link" requirements for special and revolving funds, and also given that there exist alternative methods to secure revenues for these funds, expansions and deviations of HRS Chapter 247 which go beyond the scope of the original intent of the conveyance tax law are concerning since this proposed bill, particularly if unlawfully targeting recent transactions involving the sale of interests in private entities which own real property in the State, could be characterized as

imposing an improper penalty, hidden tax, or surcharge, which may be subject to legal challenge.

- c. HB 680, SD 1 is arguably illegal and in violation of HRS Sections 37-52.3 and 37-52.4, as the Conveyance Tax revenue collected pursuant to this bill will be used to increase the Natural Area Reserve Fund (“NARF”) and other similar funds which the State Auditor has determined do not have a clear nexus between the benefits sought and charges made upon the users or beneficiaries of the program.**

Criteria for the establishment and continuance of special and revolving funds including the NARF, was enacted by the 2002 Legislature through Act 178, SLH 2002; HRS Sections 37-52.3 and 37-52.4. According to the law, in order to be approved for continuance, a special fund must:

- serve the purpose for which it was originally established;
- reflect a clear nexus between the benefits sought and charges made upon the users or beneficiaries of the program (as opposed to serving primarily as a means to provide the program or users with an automatic means of support that is removed from the normal budget and appropriation process);
- provide an appropriate means of financing for the program or activity; and
- demonstrate the capacity to be financially self-sustaining.

The first and second criteria are nearly identical to those in Act 240, SLH 1990, codified in Section 23-11, HRS, which requires the State Auditor to review, each session, all legislative bills which propose to establish new special or revolving funds.

The 2012 Auditor’s Report was issued in July, 2012, and applied the criteria in HRS Sections 37-52.3 and 37-52.4 to forty-seven (47) funds and accounts that were the subject of general fund transfer authorizations during FY2009, FY2010, and FY2011, including the NARF. The Report includes an analysis of the NARF, and states:

“...the Natural Area Reserve Fund has minimal linkage between the benefits and the fund revenue, which comes from conveyance taxes paid on real estate transactions. The fund supports programs such as the Natural Area Partnership and Forest Stewardship programs, projects undertaken in accordance with watershed management plans, and the Youth Conservation Corps. Individuals that pay this tax may benefit from the Natural Area Reserves program, but so do other Hawai‘i residents and visitors to the state.” (2012 Auditor’s Report, p. 30)

The 2012 Auditor’s Report further concluded that the NARF **did not meet the criteria for continuance, because there was no clear link between the benefits sought and user or beneficiary charges.** The Auditor further concluded that the NARF fund earmarked by the Legislature should be repealed and that the unencumbered balance should lapse to the General Fund.

In letters dated June 18, 2012 and June 22, 2012 commenting on the draft 2012 Auditor’s Report, the State Director of Finance and the State Attorney General, respectively, stated that in general, they agreed with the Auditor’s recommendations,

and did not dispute or object to the Auditor's conclusion that the NARF did not meet the criteria for continuance as a special fund, and that the NARF should be repealed.

Despite the State Auditor's findings, Conveyance Tax revenue collected pursuant to this bill are nevertheless being proposed for use to increase the NARF and other similar funds which have been determined **not** to have a clear nexus between the benefits sought and charges made upon the users or beneficiaries of the program, thereby subjecting this measure to legal challenge, and the State to a possible class-action lawsuit by all parties who paid Conveyance Taxes to finance such fund.

Programs such as the NARF deserve funding through broad taxes on the public and the State General Fund, rather than through the Conveyance Tax which targets few, is unreliable, and fluctuates with the housing market.

In its 2012 Report, the State Auditor also found that the beneficiaries of such special funds and conservation/ preservation programs are state residents as a whole, and such programs are so important that they should be supported by funding from **a broader tax on all state residents**, because of the broad state benefit.

As explained in the 2012 Auditor's Report:

"Designating revenue for specific purposes flows from the "benefit theory" of public finance, which postulates that those who benefit from a program should pay for it. Revenue earmarking is more defensible when there is a clear benefit-user charge as opposed to when there is no such linkage and earmarking is used solely as a political shield to protect a program by providing it with an automatic means of support." (2012 Auditor's Report, p. 28)

The Report also found that the NARF fell into the category of a "revenue earmark" with "no clear benefit-user charge" and that the NARF "is used solely as a political shield to protect a program by providing it with an automatic means of support." (See 2012 Auditor's Report, p. 28)

Moreover, because the Conveyance Tax is dependent on activity in the real estate market, it is considered an undependable source and should not be relied upon to fund important programs. An issue will always exist as to whether the conveyance tax rates need to be adjusted to generate more revenue in periods when the real estate market is not performing optimally.

- 3. Transfers of stock are not "conveyances" of real property, and rightfully should not be made subject to the conveyance tax law.** HB 680, SD 1 would inappropriately subject sales of controlling interests in an entity to the conveyance tax regardless of whether real estate may be the primary or largest asset owned by the entity. Given that transfers of stock are not conveyances of real property, and given the clear intent underlying HRS Chapter 247, the methods sought to be used to impose a tax on transfers of stock (i.e., amendment or expansion of the existing conveyance tax law) is improper.

4. **Landowners that build affordable housing and that otherwise provide substantial support for the programs which benefit from conveyance tax revenues should be exempted from this bill.** It is ironic and unfair that the entities which will be hardest hit by this bill are Hawaii's large landowners that build affordable housing, are stewards of the land, and are the leading partners in, and contributors to the purposes funded by conveyance tax revenues. At the very least, those landowners that build affordable housing or that support and participate in conservation and watershed programs should be exempted from this bill.
5. **The proposed bill may have unintended negative consequences** for many of Hawaii's large *kama`aina* landowners. The proposed tax will also cause hardships for local landowners who may be transferring large properties for agricultural farms, housing developments, environmental programs, or other developments which would serve the community and create needed employment.
6. **The proposed measure creates a significant disincentive for business in Hawaii.** At a time where Hawaii is attempting to encourage business expansion in, and attract business operations to Hawaii, HB 680, SD 1 actually create a disincentive, and will have a substantial negative impact on persuading new and existing businesses to open or expand in Hawaii, or to relocate their operations to this State. The proposed additional cost of doing business in Hawaii as a result of these bills would certainly appear to negatively outweigh any positive revenue impact resulting from the imposition of conveyance taxes pursuant to the measures.
7. **The imposition of conveyance tax as proposed by this bill will drive up the cost of lands for agricultural production, affordable and market homes, and commercial development.**
 - The proposed imposition of the conveyance tax on transfers which affect **agricultural lands** will be passed on to farmers and other agricultural operators, making it even harder for agriculture to survive in Hawaii.
 - The proposed imposition of the conveyance tax on transfers which affect **land intended for housing developments** will be passed on to home buyers, will increase the price of homes, and will exacerbate the affordable housing problem in Hawaii.
 - The proposed imposition of the conveyance tax onto transfers which affect **commercial properties** will also be passed on to small businesses, creating yet another substantial financial burden on them.
8. **Proper and effective implementation of the proposed bill would involve complex, time-consuming, and subjective determinations.** As a practical matter, in order that the proposed measure be properly and effectively administered and enforced, determinations as identified in the bill must be made pursuant to rules adopted by the director. These determinations necessarily include "whether or not a controlling interest is transferred or acquired," and "whether persons are acting in concert for the purpose of effectuating the transfer..." which may involve assessments of subjective issues which entail significant time and expense.

Senate Committee on Ways and Means
March 18, 2013
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For the reasons stated above, LURF respectfully recommends that **HB 680, SD 1 be held in this Committee.**

Thank you for the opportunity to provide testimony regarding this proposed measure.



COMMERCIAL REAL ESTATE
DEVELOPMENT ASSOCIATION
HAWAII CHAPTER

March 17, 2013

The Hon. David Y. Ige, Chair, and
Members of the Senate Committee on
Ways and Means

Re: Testimony in **Opposition** to H.B. No 680, HD2, and Proposed SD1, Relating to
Taxation
Hearing Date and Time: 10:00 a.m., March 20, 2013
Conference Room 211, Hawaii State Capitol

Dear Chair Ige and Members of the Committee:

I am submitting this testimony on behalf of NAIOP Hawaii in **opposition** to H.B. No 680, HD2 and Proposed SD1, relating to taxation. We are the Hawaii chapter of NAIOP, the Commercial Real Estate Development Association, which is the leading national organization for developers, owners and related professionals in office, industrial and mixed-use real estate. The local chapter comprises property owners, managers, developers, financial institutions and real estate related professionals who are involved in the areas of commercial and industrial real estate in the State of Hawaii.

NAIOP Hawaii has submitted testimony to the Legislature since the 1990s, voicing its concerns regarding the potential misuse of the conveyance tax. Unfortunately, the concerns voiced by NAIOP over the years have largely come to fruition, through dramatic increases in rates of the tax and diversion of tax revenues into areas unrelated to the conveyance tax.

The purpose of the conveyance tax was to cover the costs of running the Bureau of Conveyances. It was never intended to be a revenue-generating tax. However, over time various non-conveyance uses for the conveyance tax revenue have been proposed and implemented by the Legislature. While these causes might be worthy, they were never intended to be supported by the conveyance tax. There is no nexus between the tax and the uses for which the tax will be used.

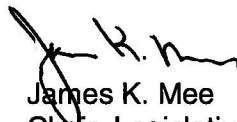
The rates of the tax have also been increased dramatically in the past several years. At this point it has become a punitive surtax on many real estate transactions. It is no longer a conveyance tax but a type of capital gains tax surcharge. However, it is more onerous than a true capital gains tax, because not just the gain on the transfer is taxed, but instead the entire face value of the transaction. Indeed, even if the conveyance is at a loss, the tax is imposed. And it is a hidden tax, because it only shows up as an expense line item on a closing statement.

We believe the continuing misuse of this tax is harmful to the economy and reinforces the perception of Hawaii as a high-tax jurisdiction which is to be avoided for investment and business purposes.

The David Y. Ige, Chair, and Members of the Senate Committee on
Ways and Means
March 17, 2013
Page 2

Thank you for the opportunity to testify on this measure.

Respectfully,

A handwritten signature in black ink, appearing to read "J. K. Mee", is written over the printed name.

James K. Mee
Chair, Legislative Affairs Committee



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March 15, 2013

Testimony to the Senate Ways & Means Committee

Wednesday, March 20, 2013

10:00 a.m.

State Capitol, Conference Room 211

RE: H.B 680 HD2, SD1 (Proposed) Relating to Taxation

Dear Chair Ige and Vice Chair Kidani, Members of the Committee:

My name is Anthony Borge, General Manager of RMA Sales. We are a small, locally owned and operated company that's been in business since 1961. We manufacture and distribute vinyl, aluminum window and door products as well as other related building materials throughout the State. RMA Sales is also a member of the Building Industry Association of Hawaii.

We are **opposed** to **H.B 680 HD2, SD1** that which proposes to clarify/define the selling, transfer, or exchange of a legal entity's stock to an unrelated entity or individual, that includes real estate in Hawaii to be a conveyance of realty and thus subject to the Conveyance Tax.

The Conveyance Tax was created to cover the administrative cost of recordation of real estate transactions by the Bureau of Conveyance within the State of Hawaii. The proposed amendments to the statutes would have the Conveyance Tax deposited into the general fund and earmarking various percentages from the Conveyance Tax to fund programs that have nothing to do with the conveyance of real property. This is neither the purpose nor the intent of the Conveyance Tax.

It is for this reason we are opposed to H.B 680 HD2, SD1.

Thank you.

Respectfully submitted by:

Anthony B. Borge

THE TRUST *for* PUBLIC LAND

CONSERVING LAND FOR PEOPLE

THE TRUST FOR PUBLIC LAND'S TESTIMONY IN SUPPORT OF HB 680, SD 1 RELATING TO TAXATION

Senate Committee on Ways & Means

Wednesday, March 20, 2013, 10:00 AM, Room 211

The Trust for Public Land supports HB 680, SD 1. We believe this bill appropriately closes a major loophole to the conveyance tax on transfers of real estate – real estate transferred via a majority stock transfer.

Only sophisticated and wealthy individuals can afford to take advantage of the current loophole by forming corporations or limited liability companies that “own” real estate and transferring the stock ownership of the company, which effectively conveys the ownership of the real estate. For example, although real estate worth hundreds of millions of dollars on Lana‘i was sold last year to billionaire Larry Ellison, the State did not collect any real estate conveyance taxes because of this stock transfer loophole.

Under HRS §247-7, a portion of conveyance tax revenue has been appropriately used for land preservation and forested watershed conservation via the Land Conservation Fund and the Natural Area Reserve Fund (another portion is directed to the Affordable Housing Rental Trust Fund). Since the development and sale of real estate puts pressure on our natural resources like fresh water and our watersheds, it makes sense to spend a portion of conveyance tax revenue on protecting those natural resources.

We do note that an exemption for affordable housing rental projects seems to have been inadvertently omitted from SD 1. We support amending SD 1 to include that exemption language:

Any transfer from a limited partner to a general partner of a limited partnership that owns an affordable rental housing project for which low-income housing tax credits have been issued under section 235-110.8 or 241-4.7 or section 42 of the Internal Revenue Code of 1986, as amended

Although the Trust for Public Land supports this bill, I will not be able to appear in person to testify due to a scheduling conflict.

Mahalo for this opportunity to testify -



Lea Hong
Hawaiian Islands State Director
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SUBJECT: CONVEYANCE, Transfer of a controlling interest

BILL NUMBER: HB 680, Proposed SD-1

INTRODUCED BY: Senate Committee on Ways and Means

BRIEF SUMMARY: 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; and (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 percent 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.

The disclosure of the required filing of a certificate of conveyance, the report of any investigation of a certificate or the subject matter of a certificate shall be confidential. Violation of this provision shall constitute a misdemeanor.

Amends HRS section 247-1 to provide that a conveyance tax shall be levied, collected, and paid on each conveyance of any interest in real property.

Amends HRS section 247-2 to provide that the conveyance tax shall be based on the consideration paid or to be paid on all conveyances of real property. Replaces the term “value” with “consideration” and the term “sale” with “conveyance.”

Amends HRS section 247-3 to replace the terms “document or instrument” with “conveyance” and provides that any conveyance to effectuate a mere change of identity or form of ownership or organization where there is no change in beneficial ownership, other than a conveyance to a cooperative housing corporation as defined in section 421I-1, or limited-equity housing cooperative, as defined in section 421H-1, of the real property comprising the cooperative dwelling or dwellings, shall be exempt from the conveyance tax.

Amends HRS section 247-4 to provide that the conveyance tax shall be paid by the grantor, unless the grantor is the United States or any agency or instrumentality thereof, or the state or any agency, instrumentality, or governmental or political subdivision, then the tax shall be paid by the grantee. If a grantor fails to pay the conveyance tax at the required time or if the grantor is exempt from paying the tax, the grantee shall pay the tax; provided that if the grantee has the duty to pay the tax because the grantor failed to pay the tax, then the grantor and the grantee shall be jointly liable for the tax. All conveyances shall be presumed taxable. In the case where the consideration includes property other than money, the consideration shall be presumed to be the fair market value of the real property. Stipulates

that these presumptions shall prevail until the contrary is proven and the burden of proving the contrary shall be on the person liable for payment of the tax.

Amends HRS section 237-5 to provide that except for a conveyance where no instrument evidencing the conveyance is recorded or filed with the registrar of conveyances or the assistant registrar of the land court, the tax shall be evidenced as paid by the imprinting of a seal on the document or instrument, which shall indicate on its face the amount of the tax paid.

Amends HRS section 247-6 to replace the terms “any party” with “grantor and grantee,” “property transferred” with “conveyance,” “document or instrument” with “conveyance” and in the case of a conveyance exempted due to a transfer on death deed, require the grantor and the grantee to file a certificate declaring that the conveyance conforms to the transfer on death deed and for any conveyance exempted under HRS section 247-3(16), the grantor and the grantee shall file a certificate declaring that the conveyance effectuates a mere change of identity or form of ownership or organization where there is no change in beneficial ownership. If any or all of the grantors or any or all of the grantees, or their authorized representatives, have failed to sign the required certificate, the certificate shall be accepted if it is signed by any one of the grantors or by any one of the grantees; provided that the grantors and grantees not signing the certificate, personally or through their authorized representative, shall not be relieved of any liability for the conveyance tax and the period of limitations for assessment of any tax shall not be applicable.

Defines “controlling interest” as: (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, 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. Provides that: (1) persons are acting in concert when they have a relationship such that one person influences or controls the actions of another; and (2) where the individuals or entities are not commonly controlled or owned, persons shall be treated as acting in concert when the unity with which the sellers or purchasers have negotiated and will consummate the transfer of ownership interests indicates they are acting as a single entity. If transfers or acquisitions are completely independent, with each grantor selling or grantee buying without regard to the identity of the other grantors or grantees, then the transfers or acquisitions shall be treated as separate transfers or acquisitions. Delineates factors that indicate whether persons are acting in concert.

Notwithstanding the definition of “controlling interest” the conveyance tax shall apply to: (1) the original conveyance of shares of stock in a cooperative housing corporation as defined in HRS section 421I-1, or limited-equity housing cooperative as defined in HRS section 421H-1, in connection with the grant or transfer of a right of occupancy by the cooperative housing corporation or limited-equity housing cooperative; and (2) the subsequent conveyance of the stock in a cooperative housing corporation or limited-equity housing cooperative in connection with the grant or transfer of a right of occupancy by the owner thereof. For purposes of determining whether or not a controlling interest is transferred or acquired, only transfers or acquisitions of interests occurring on or after July 1, 2014 shall be added together. A transfer or acquisition made pursuant to a binding written contract that was entered into on or before July 1, 2014, shall not be taxable.

A transfer or acquisition of an interest in an entity that has an interest in real property, on or after July 1, 2014, that is followed by a subsequent transfer or acquisition of an additional interest or interests in the same entity, the transfers or acquisitions shall be added together to determine if a transfer or acquisition of a controlling interest has occurred. A transfer or acquisition of a controlling interest in an entity, on or after July 1, 2014, where the real estate transfer tax is paid on that transfer or acquisition and there is a subsequent transfer or acquisition of an additional interest in the same entity, it shall be considered that a second transfer or acquisition of a controlling interest has occurred which shall be subject to the conveyance tax. No transfer or acquisition of an interest in an entity that has an interest in real property shall be added to another transfer or acquisition of an interest in the same entity if the transfers or acquisitions occur more than three years apart, unless the transfers or acquisitions were so timed as part of a plan to avoid the real estate transfer tax.

For purposes of applying the tax imposed under this chapter to the transfer or acquisition of a controlling interest in an entity, the tax shall be imposed only when there is a transfer and an acquisition of a controlling interest in the same conveyance.

Defines “consideration” as the price actually paid or required to be paid for the real property or interest therein, including: (1) payment for an option or contract to purchase real property, whether or not expressed in the deed and whether paid or required to be paid by money, property, or any other thing of value; (2) cancellation or discharge of an indebtedness or obligation; or (3) the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether or not the underlying indebtedness is assumed or taken subject to; provided that, in the case of a controlling interest in any entity that owns real property, consideration shall mean the fair market value of the real property or interest therein, apportioned based upon the percentage of the ownership interest transferred or acquired in the entity.

Defines “conveyance” as the transfer or transfers of any interest in real property by any method, including but not limited to sale, exchange, assignment, surrender, mortgage foreclosure, transfer in lieu of foreclosure, option, trust indenture, taking by eminent domain, conveyance upon liquidation or by a receiver, or transfer or acquisition of a controlling interest in any entity with an interest in real property; provided that the conveyance of an interest in real property shall include the creation of a leasehold or sublease.

Further defines “grantee,” “grantor,” “interest in the real property” and “real property” for purposes of the measure.

This act shall be applicable to all conveyances of interests in real property occurring after June 30, 2014.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: It appears that the proposed measure attempts to make the conveyance tax into a comprehensive revenue generating tax by imposing the conveyance tax rates on “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 no 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. It also appears that this measure proposes to extract “lost” conveyance tax revenue by making a grantor and/or grantee liable for any conveyance tax due.

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. The measure attempts to carve out or exempt transactions between entities wholly owned by the same common ownership that results in no change in the beneficial ownership. Whether or not this would cover instances where partnerships are dissolved should be questioned. If a partnership dissolves and each of the parties takes some or all of the portfolio of real estate, will that meet the “related entity” transfer that this clause of the bill attempts to address?

This measure is ill-conceived, submitted as a Pavlovian response to recent acquisitions of entities which happened to own substantial holdings of local realty. But have lawmakers truly thought this one through to understand the potential impact and ramifications of other types of acquisitions? For example, two major office supply firms entered into negotiations to merge their operations of maximizing efficiencies of scale and reduce overhead costs. Each has a number of retail outlets as well as warehousing facilities. Since one company is merging with the other where one of the companies will have controlling interests, will that merger be subject to this proposal? Or take the example of credit unions which in recent years the number of which has dwindled due to mergers and acquisitions that enable the smaller entities to survive because the overhead expenses are absorbed by the larger entity. Would that acquisition or merger be subject to this proposal if each entity owns substantial realty?

The bottom line is that the drive to “punish” speculators in Hawaii real estate by imposing such confiscatory conveyance tax rates has resulted in these clever transfers of entities that happen to own real

property in Hawaii. As a result, valuable information has been lost because there is no indicator of how much value was transferred and, therefore, benchmarks in helping to set values of other real property of similar shape and size have been lost. Obviously, previous legislatures took aim at speculators by establishing the highest conveyance tax rates on nonowner occupied residential property, property that might also include the sale of an affordable rental facility. The current structure of rates also ignores the transfer of commercial property that can be worth millions of dollars which now has resulted in this approach that circumvents the conveyance of real property but transfers ownership of an entity or company. As such, the conveyance tax as now structured sends a very loud message that Hawaii is not a place in which anyone should invest or attempt to do business.

To reiterate, when the conveyance tax was enacted in 1966 by Act 10, it was never intended as a source of revenue but as a means by which to determine and record the value of real property as it was transferred from buyer to seller at a rate of five cents per hundred dollars of value and, as such, was an inconsequential cost in the transaction. It remained at that rate until the early 1990's after several attempts had been made to raise the tax rate in 1988. Initially the rate was doubled to ten cents with the proceeds earmarked for the affordable rental housing trust fund and the natural area reserves program or the Na Ala Hele program.

Advocates of this fund argued and continue to argue that there is a connection or nexus for these programs and the conveyance tax because the sale of realty in Hawaii is driving the cost of housing up (therefore the affordable rental housing trust fund) and that further development of residential and commercial property is encroaching on the state's natural areas, on its watershed, and forests (therefore the natural area reserves fund). What the advocates refuse to acknowledge is that the rising cost of realty is a natural occurrence in any community as population increases and that as a result of the state's land use policy, less than five percent of the state's last mass is designated for urban use. With such a limited supply of land available for development that is for use by people, the argument that development is encroaching on the state's natural areas is facetious to say the least. Concurrently, with such a limited supply of land available for development or inhabitation, the law of supply and demand dictates that the cost of what supply is available will rise in direct contrast with that limited supply. Thus, the causes cited reflect a skewed, if not uninformed, conclusion.

The other issue which has driven the conveyance tax to be the anomaly that it is today is the drive to punish speculators in Hawaii real estate. However, in that drive lawmakers have basically destroyed Hawaii's image as a place to do business. While all conveyance tax rates are higher than the original rate, as structured, the higher rates are biased against non residential or commercial property and residential property that is not owner occupied and against higher valued properties. While those who proposed and those who eventually voted to adopted this fee structure may want to deny that this was the case, why then the reason for introducing this proposal? Is the perception that any transaction topping the million dollar mark represents the filthy rich speculating investor and, therefore, is not only capable of paying such a high rate on the transaction but should be punished for paying exorbitant prices for the acquisition of the realty. What this assumption fails to realize is that the investment of new capital in Hawaii is critical to the growth and prosperity of Hawaii's future. Thus, with an attitude that any major transaction is a "bad" transaction that is beset with a punitive conveyance tax rate sends a very loud message that policymakers in Hawaii do not welcome investment of any substance. It also runs contrary to a pronounced intent to support affordable housing in Hawaii as affordable housing can only be realized with economies of scale meaning that a development must be of a size that will marginalize

overhead costs over a large number of units which means that the initial transaction that leads to such development will incur the highest conveyance tax rates.

These highest tax rates on such large transactions have created the problem that this proposal attempts to address. This attempt to impose the conveyance tax on the transfer of realty by taxing as a transaction that is aimed at the transfer of controlling interests in an entity that holds realty in Hawaii is evidence that those high conveyance tax rates have forced entrepreneurs to find ways to avoid those high tax rates. The problem created is the loss of information of the value of those transactions which the real property assessors are beginning to realize. Thus, in the legislative greed to find new sources of financing for their programs, more problems have been created than solved by utilizing this tax as a source of funding. While it is unlikely that policymakers and the beneficiaries of these funds will be willing to give up this source of funding, the public should acknowledge and hold these policymakers and advocates responsible for making the tax system in Hawaii less than efficient. Those who advocated this system should also be held responsible for creating the image that Hawaii is a less than desirable place to invest and do business.

Digested 3/18/13



**Testimony to the Senate Committee on Ways and Means
Wednesday, March 20, 2013
10:00 a.m.
State Capitol - Conference Room 211**

RE: HOUSE BILL NO. 680 HD 2, SD 1 (PROPOSED), RELATING TO TAXATION

Chair Ige and Vice Chair Kidani, and members of the committee:

The Chamber of Commerce of Hawaii opposes H.B 680 HD 2, SD1. The bill proposes amendments to Chapter 247 HRS that would impose a conveyance tax on the conveyance of a controlling interest of an entity with an interest in real property in the State.

The Chamber is the largest business organization in Hawaii, representing more than 1,000 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.

This bill would amend HRS § 247 by defining "Conveyance" as the transfer or transfers of any interest in real property by any method, including but not limited to sale, exchange, assignment, surrender, mortgage foreclosure, transfer in lieu of foreclosure, option, trust indenture, taking by eminent domain, conveyance upon liquidation or by a receiver, or transfer or acquisition of a controlling interest in any entity with an interest in real property. Conveyance of an interest in real property shall include the creation of a lease-hold or sublease.

The purpose is an attempt to close what is perceived to be a "loop-hole" in the current law in which the conveyance of an entire business or entity with real estate holdings is not presently subject to the Conveyance tax. However, it appears that the real issue is not the imposition of the conveyance tax on these types of business transactions but to increase the funds raised through the conveyance tax for purposes unrelated to the documentation of the real estate transaction.

The Conveyance Tax was created to cover the administrative costs of recording the real estate transactions, such as those performed by the Bureau of Conveyance. With the recent amendments to the statutes, the conveyance tax is deposited into the general fund with the following allocations:

1. Ten per cent shall be paid into the **Land Conservation Fund** established pursuant to section 173A-5;

2. Twenty-five per cent from July 1, 2009, until June 30, 2012, and thirty per cent in each fiscal year thereafter shall be paid into the **Rental Housing Trust Fund** established by section 201H-202; and
3. Twenty per cent from July 1, 2009, until June 30, 2012, and twenty-five per cent in each fiscal year thereafter shall be paid into the **Natural Area Reserve Fund** established by section 195-9; provided that the funds paid into the natural area reserve fund shall be annually disbursed by the department of land and natural resources in the following priority:
 - a. To natural area partnership and forest stewardship programs after joint consultation with the forest stewardship committee and the natural area reserves system commission;
 - b. Projects undertaken in accordance with watershed management plans pursuant to section 171-58 or watershed management plans negotiated with private landowners, and management of the natural area reserves system pursuant to section 195-3; and
 - c. The youth conservation corps established under chapter 193.

We are deeply troubled by the manner in which the Conveyance Tax has been used to generate reviews for unrelated purposes. There is no rational nexus between the real estate transactions that are being taxed at conveyance, and the uses identified in HRS 247 as the beneficiaries of the tax. We do not believe that the conveyance tax is being used in an appropriate manner. We believe the Auditor of the State of Hawaii had similar findings.

In July 2012 the Auditor of the State of Hawaii prepared a report entitled, "Study of the Transfer of Non-general Funds to the General Fund." Report No. 12-04. On page 26 of the report, the Auditor found:

"In 2002, the Legislature set the criteria for determining whether special or revolving funds should be established or continued through Act 178, SLH 2002 and codified in Sections 37-52.3 and 37-52.4, HRS. To justify the creation and continuance, the Legislature must ensure that a special or revolving fund:

- serves the purpose for which it was originally established;
- reflects a clear nexus between the benefits sought and charges made upon the users or beneficiaries of the program, as opposed to serving primarily as a means to provide the program or users with an automatic means of support that is removed from the normal budget and appropriation process; . . ."

The Report also contains the following findings on two of the funds receiving funding through the Conveyance Tax (pages 29 and 30):

"Another example of a fund that has no benefit-user charge linkage is the Department of Land and Natural Resources' Land Conservation Fund. Under Section 247-7(1), HRS, the Legislature authorized funding from 10 percent of the state real property conveyance tax receipts. However, the purpose of the fund is to conserve and protect lands having value as a resource to the state through either acquisition of property or through permanent conservation easements to protect resource values. Hence, beneficiaries of the conservation and preservation programs are state residents as a whole, and as such the programs should be supported by funding from a

broader tax because of the broad public benefit. Although the Legislature determined the conveyance tax an appropriate means of funding conservation of natural resources, the Land Conservation Fund established under Section 247-7(1), HRS, the program should draw support from the general fund rather than a tax charged on individuals and companies involved in real estate transactions.”

“Likewise, the Natural Area Reserve Fund has minimal linkage between the benefits and the fund revenue, which comes from conveyance taxes paid on real estate transactions. The fund supports programs such as the Natural Area Partnership and Forest Stewardship programs, projects undertaken in accordance with watershed management plans, and the Youth Conservation Corps. Individuals that pay this tax may benefit from the Natural Area Reserves program, but so do other Hawai'i residents and visitors to the state.”

Finally, we question whether this specific type of legislation would even be introduced if the Conveyance tax were limited to its original purpose of recording real estate transactions.

Thank you for the opportunity to express our views on this matter.

Testimony of The Nature Conservancy of Hawai'i
Supporting with Amendments H.B. 680 Proposed SD1 Relating to Taxation
Senate Committee on Ways and Means
Wednesday, March 20, 2013, 10:00AM, Room 211

The Nature Conservancy of Hawai'i is a private non-profit conservation organization dedicated to the preservation of the lands and waters upon which life in these islands depends. The Conservancy has helped to protect nearly 200,000 acres of natural lands in Hawai'i. Today, we actively manage more than 35,000 acres in 11 nature preserves on Maui, Hawai'i, Moloka'i, Lāna'i, and Kaua'i. We also work closely with government agencies, private parties and communities on cooperative land and marine management projects.

The Nature Conservancy supports the proposed H.B. 680 SD1, and we request some amendments noted below. We think it is reasonable that, like direct transfers of real estate via purchase and sale agreements, transfers of real estate via majority stock transfers should also be subject to the State's real estate conveyance tax.

As for the issue of nexus, under HRS §247-7 a portion of conveyance tax revenue has been appropriately used for land preservation and forested watershed conservation via the Land Conservation Fund and the Natural Area Reserve Fund, respectively. The development and sale of real estate helps drive Hawaii's economy and is helping lift us out of the recent recession, but it also puts pressure on our natural resources like fresh water. Fresh water is clearly a limiting factor here in the middle of the Pacific. Several locations in the state are experiencing ongoing drought, water management areas being declared, climate change is likely to produce more severe storms but overall less rainfall, and the UH's 2011 Rainfall Atlas catalogues a century of declining rainfall that is worse in recent decades. Fresh water is not a limitless resource that can forever be tapped to support our developed real estate. It makes sense to spend a portion of conveyance tax revenue on protecting those natural resources. **The Legislature recognized this clear nexus in Act 156 (HB 1308 CD1, 2005), stating:**

The legislature has also determined that there is a clear nexus between the source of the conveyance tax and providing funding for watershed protection and other natural resource preservation programs. The development, sale, and improvement of real estate in Hawaii adds additional pressure on natural areas, coastal access, agricultural production, and Hawaii's water resources and watershed recharge areas.

Proposed Amendments. We also support the following amendments to this bill that were part of SB 97 SD2 as passed by the Senate and that are reasonable tax limitations or exemptions for stock transfers between wholly owned entities, related partners, subsidiaries, or affordable housing projects that support true business partnerships while preventing the formation of entities just to avoid the conveyance tax.

At p.9, §247-C, insert the following amendment:

"(3) Any document or instrument conveying real property, or any interest therein, to or from a wholly owned corporation or wholly owned limited liability company of the grantor or grantee, respectively."

BOARD OF TRUSTEES

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At p. 20, §247-3, insert the following amendment:

“(16) Any conveyance from a limited partner to a general partner of a limited partnership that owns an affordable rental housing project for which low-income housing tax credits have been issued under section 235-110.8 or 241-4.7 or section 42 of the Internal Revenue Code of 1986, as amended; and

“(17) Any conveyance that consists solely of a change in controlling interest in an entity holding an interest in realty between persons with ownership interests in such entity for a minimum of three years immediately preceding the transfer ~~Any conveyance to effectuate a mere change of identity of form of ownership or organization where there is no change in beneficial ownership, other than a conveyance to a cooperative housing corporation as defined in section 421I-1 or limited equity housing cooperative defined in section 421H-1, of the real property comprising the cooperative dwelling or dwellings.~~”

At p. 27, §247-6, insert the following amendment:

“(11) For any conveyance exempted under section 247-6(16), the grantor and the grantee shall file a certificate declaring that the conveyance is from a limited partner to a general partner of a limited partnership that owns an affordable rental housing project for which low-income housing tax credits have been issued under section 235-110.8 or 241-4.7 or section 42 of the Internal Revenue Code of 1986, as amended ~~effectuates a mere change of identity or form of ownership or organization where this is no change in beneficial ownership.~~

“(12) For any conveyance exempted under section 247-6 (17), the grantor and the grantee shall file a certificate declaring that the conveyance consists solely of a change in controlling interest in an entity holding an interest in realty between persons with ownership interests in such entity for a minimum of three years immediately preceding the transfer.”

Thank you the opportunity to testify in support of this measure.