

NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION

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FREDERICK D. PABLO
DIRECTOR OF TAXATION

JOSHUA WISCH
DEPUTY DIRECTOR

To: The Honorable Cindy Evans, Chair
and Members of the House Committee on Water and Land

Date: Monday, February 3, 2014
Time: 9:15 A.M.
Place: Conference Room 325, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. 1850, Relating to Taxation

The Department appreciates the intent of H.B. 1850, and provides the following information and comments for your consideration.

H.B. 1850 makes significant changes to the conveyance tax, particularly making transfers of controlling interest in entities holding title to real property in the State subject to the conveyance tax. The bill also taxes certain currently exempt transactions at the lowest rate and adds new transactions that are also taxed at the lowest rate.

In general, the Department has concerns that large-scale changes to the conveyance tax may have unintended consequences, particularly in the area of compliance, and that taxpayers may construe the changes to be a change in the Department's position.

The Department suggests the following amendments:

First, the Department notes that this bill deletes language from Section 247-2, Hawaii Revised Statutes (HRS), which set forth what might be considered "consideration" under the law. The Department suggests including the language from Section 247-2, HRS, into the new definition of "consideration" so that proposed amendments will not be construed as a change in the Department's position.

Second, the Department is not certain that the proposed confidentiality requirements are necessary as they do not exist in the law today and may interfere with the ability of the

Department and the Department of the Attorney General to enforce compliance. The Department suggests the addition of an exception to the confidentiality requirements for the purposes of law enforcement.

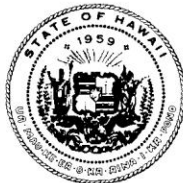
However, if the intent of this provision is to keep controlling interest transfers confidential in other settings as well, the Department suggests that the confidentiality requirement be limited only to certain information on the Conveyance Tax Certificate, such as grantor and grantee identities, for controlling interest transfers. Since much of the information on the Conveyance Tax Certificate is currently published or made available by the counties, the Department does not believe that all of the information on the certificate should be deemed confidential.

Third, the Department notes that in the tax context, the definition of "willfully" is slightly different than the one used in other criminal contexts. If the confidentiality provisions are kept, the Department suggests that reference be made to Section 231-40, HRS, which contains the definition of "willfully" as generally used with respect to the enforcement of laws in Title 14, HRS.

Finally, the Department suggests a change to the exemption proposed in Section 247-3(17), HRS. If the intent of this provision is to provide an exemption for transfers of ownership of an entity between family members or small business owners, the Department suggests including additional requirements that must be satisfied before an exemption may be claimed. An example of an additional requirement that may be considered is number of persons with an ownership interest in the entity before and after the transfer.

Thank you for the opportunity to provide comments.

NEIL ABERCROMBIE
GOVERNOR



CRAIG K. HIRAI
EXECUTIVE DIRECTOR

STATE OF HAWAII

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT AND TOURISM
HAWAII HOUSING FINANCE AND DEVELOPMENT CORPORATION
677 QUEEN STREET, SUITE 300
Honolulu, Hawaii 96813
FAX: (808) 587-0600

IN REPLY REFER TO:

WRITTEN ONLY

Statement of
Craig K. Hirai
Hawaii Housing Finance and Development Corporation
Before the

HOUSE COMMITTEE ON WATER & LAND

February 3, 2014 at 9:15 a.m.
State Capitol, Room 325

In consideration of
H.B. 1850
RELATING TO TAXATION.

The HHFDC **supports the intent** of H.B. 1850 to the extent that the bill would increase conveyance tax revenues to the Rental Housing Trust Fund. The sole dedicated source of funding for the Rental Housing Trust Fund is 30 percent of conveyance tax proceeds to address the need for affordable rental housing statewide.

HHFDC leverages the Rental Housing Trust Fund with other funding sources to finance the development of critically needed affordable rental housing through public-private partnerships. As of December 31, 2013, 4,567 affordable rental units have been produced or are in development in 58 projects statewide. In Fiscal Year 2013, the Rental Housing Trust Fund received \$16.4 million from its share of conveyance tax revenues.

Thank you for the opportunity to provide written comments on this bill.

Testimony of The Nature Conservancy of Hawai'i
Supporting H.B. 1850 Relating to Taxation
House Committee on Water & Land
Monday, February 3, 2014, 9:15AM, Room 325

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 H.B. 1850. 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.

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 these 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.

Thank you for this opportunity to offer our support for this measure.

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SUBJECT: CONVEYANCE, Transfer of a controlling interest

BILL NUMBER: SB 2556; HB 1850 (Identical)

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

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 amount of consideration: (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.

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.

Amends HRS section 247-3 to replace the terms “document or instrument” with “conveyance” and provides that: (1) 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 HRS section 235-110.8 or 241-4.7 or section 42 of the Internal Revenue Code of 1986, as amended; and (2) any conveyance that consists solely of a transfer or acquisition of a controlling interest in an entity between persons who have each held an ownership interest in the entity for a minimum of three years immediately preceding the conveyance, 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. 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 247-5 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.” Delineates provisions delineating the filing of certificate for conveyances that are exempt.

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 a 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.

Provides that the determination of 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 on or after July 1, 2015, does not have to be included for purposes of determining whether or not a controlling interest is transferred or acquired; provided that the transfer or acquisition is made pursuant to a binding written contract that was entered into before July 1, 2015.

In the case of a transfer or acquisition of an interest in an entity that has an interest in real property, on or after July 1, 2015, 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.

In the case of a transfer or acquisition of a controlling interest in an entity, on or after July 1, 2015, where the conveyance 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 conveyance tax.

For the 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 when there is a transfer or 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, 2015.

EFFECTIVE DATE: July 1, 2015

STAFF COMMENTS: The proposed measure attempts to make the conveyance tax into a comprehensive revenue generating tax by imposing the conveyance tax rates on “complex transactions” resulting in the indirect transfer of real property. Just as the federal tax code imposes withholding tax on transfers of “U.S. real property holding corporations” as well as U.S. real property, this bill is trying to ensure that transfers of entities holding Hawaii real property are taxed under the conveyance tax just like the transfers of the real property itself. Proponents have pointed to the recent sale of the Island of Lanai and noted that no conveyance tax was paid, primarily because the buyer bought a corporation that owned the island rather than the island itself.

We see two major concerns with this effort.

First, the current conveyance tax was never established to be a source of revenue. It 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 (which then was administering the real property tax on a statewide basis) 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. It was enacted at a very low nominal rate. Over the years the tax has been increased from half a cent per \$100 of value transferred to \$1.25 in the highest tax brackets. Conveyance tax revenues have been tapped to provide revenue for the land conservation fund, rental housing trust fund, and the natural area reserve fund. Thus, in past years it might not have made sense to take the trouble to drop a parcel of land into an entity simply to avoid the conveyance tax; now, with tax rates up to 250 times what they had been, it's a different story.

Second, the agency set up to capture the tax is the Hawaii Bureau of Conveyances. It records deeds and other conveyance instruments that are presented to it. There is no problem having the Bureau review documents for certain exemptions based on the tenor of the document. But with this bill, someone will need to look out for transactions (purchases and sales of interests in entities) that aren't normally required to be reported to anyone. Certainly the Bureau is not institutionally equipped to do that, and it might be a stretch for the Department of Taxation which has had only limited involvement with this tax before.

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.

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. 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. 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.

Digested 1/31/14

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Testimony of Hawai'i Appleseed Center for Law and Economic Justice
Supporting HB 1850 Relating to Taxation
House Committee on Water and Land
Scheduled for Hearing Monday, February 3, 2014 9:15 AM, Room 325

Hawai'i Appleseed Center for Law and Economic Justice is a nonprofit, 501(c)(3) law firm created to advocate on behalf of low income individuals and families in Hawai'i on civil legal issues of statewide importance. Our core mission is to help our clients gain access to the resources, services, and fair treatment that they need to realize their opportunities for self-achievement and economic security.

Thank you for the opportunity to testify **in support** of House Bill 1850. Ensuring that any transfers of controlling interests in commercial entities which involve real property are subject to the conveyance tax like any other sale of property is a matter of fairness. Our land is particularly precious in Hawai'i, and all transfers of real property should be recognized as such. We lost six million dollars in conveyance tax revenue when Lanai was sold because of what is essentially a loophole in the conveyance tax. In addition, it is possible that some transfers of real estate are structured as the transfer of commercial entities to avoid paying the conveyance tax.

The conveyance tax funds both affordable housing through the Rental Housing Trust Fund and important state environmental protection initiatives. Conveyance tax revenues are the only dedicated source of funding for the Rental Housing Trust Fund, a critical tool in the creation of affordable housing. In the next three years, Hawai'i will need 13,000 more units to meet the need for affordable rentals. As a result of this shortfall, families struggle to keep themselves housed, and may even find themselves homeless. The Rental Housing Trust Fund has helped to create over 4,567 units, significant progress in addressing our need for housing. Increasing conveyance tax revenues by taxing all real property transfers fairly will help increase the availability of funds to this program. The public-private partnerships created by the fund help build long broader, long-term strategies to address our affordable housing needs on all islands and function as an economic driver through job creation.

However, the Trust Fund is not able to fund many qualified projects due to lack of funds. It received \$37 million in project requests in FY 2012 alone. That year, five out of nine projects (totaling 317 affordable rental units), were left unfunded. In 2013, the Trust Fund received \$70.4 million in requests. Many projects are ready to be developed and only waiting on funding.

Subjecting realty included in transfers of controlling interests is a fair and equitable application of the conveyance tax that helps support critical affordable housing and environmental initiatives. Transfers of real property impact our housing market, including our stock of affordable housing. This nexus means that all property transfers, regardless of form, should be taxed as such.



CATHOLIC CHARITIES HAWAII

TESTIMONY IN SUPPORT OF HB 1850: RELATING TO TAXATION

TO: Representative Cindy Evans, Chair, Representative Nicole E. Lowen, Vice Chair, and Members, Committee on Water and Land

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

Hearing: Monday, February 3, 2014; 9:15 am; CR 325

Chair Evans, Vice Chair Lowen, and Members, Committee on Water and Land:

Thank you for the opportunity to testify in **support** of HB 1850, which imposes a conveyance tax on the conveyance of a controlling interest of an entity with an interest in real property in the state. I am Betty Lou Larson, Legislative Liaison for Catholic Charities Hawaii. Catholic Charities Hawaii supports this bill.

When the island of Lanai was sold, no conveyance tax was paid. Yet if a house or a business is sold, the conveyance tax is paid. We feel that it is fair that transfers of real estate via majority stock transfers, like direct transfers of real estate via purchase and sale agreements, should be subject to the conveyance tax. 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.

Catholic Charities Hawaii receives hundreds of calls each month from families that need affordable housing. Rents in Hawaii have increased by more than 45% since 2005. Hawaii rents exceed the national median by over 70%. Hawaii has the highest rate of homelessness in the US, with almost 14,000 individuals receiving services for homelessness in FY 2013. 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 **4,567 affordable rental units since inception**. 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. The other five projects (317 possible units) were left on the drawing board due to limited resources. In **2013, the Trust Fund received \$70.4 million in requests**. Many projects are ready to be developed and are only waiting for funding.

We urge your support to close this tax loophole and tax the value of the real estate. This is a fairness issue first. Additionally, the bill would have a beneficial impact on affordable housing and land protection.



NEIL ABERCROMBIE
GOVERNOR OF HAWAII



**STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES**

POST OFFICE BOX 621
HONOLULU, HAWAII 96809

**Testimony of
WILLIAM J. AILA, JR.
Chairperson**

**Before the House Committee on
WATER & LAND**

**Monday, February 3, 2014
9:15 AM
State Capitol, Conference Room 325**

**In consideration of
HOUSE BILL 1850
RELATING TO TAXATION**

House Bill 1850 proposes to impose a conveyance tax on the conveyance of a controlling interest of an entity with an interest in real property in the State, and applies to conveyances occurring after June 30, 2015. **The Department of Land and Natural Resources (Department) supports this bill.**

This bill benefits the recipients of the conveyance tax, including the Department's Natural Area Reserve Fund and Land Conservation Fund.

In 2006, the Legislature determined that 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. To protect Hawaii's invaluable ecosystems and water supplies, a dedicated funding mechanism was created for the Natural Area Partnership Program, the Natural Area Reserves, the Watershed Partnerships Program, and the Youth Conservation Corps through the tax paid on conveyances of land (Hawaii Revised Statutes (HRS) §247-7). These revenues are deposited into the Natural Area Reserve Fund, established by HRS §195-9, which supports land management actions on six major islands and engages over 60 public-private landowners, partners, and agencies.

The Land Conservation Fund supports the Legacy Land Conservation Program (LLCP). The LLCP protects rare and unique cultural, natural, agricultural, and recreational resources from destruction by funding the acquisition of fee title or conservation easements by nonprofits, counties, and state agencies.

This bill also supports the Rental Housing Trust Fund and the General Fund which also receive a portion of conveyance tax revenues.

WILLIAM J. AILA, JR.
CHAIRPERSON
BOARD OF LAND AND NATURAL RESOURCES
COMMISSION ON WATER RESOURCE MANAGEMENT

ESTHER KIA'AINA
FIRST DEPUTY

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KAHOOLAWE ISLAND RESERVE COMMISSION
LAND
STATE PARKS



PARTNERS IN CARE
Oahu's Coalition of Homeless Providers

Partners in Care is a coalition of Oahu's homeless service providers, government and community stakeholders working together to end homelessness. We believe that partnerships and collaboration are essential.

TESTIMONY IN SUPPORT OF HB 1850: RELATING TO TAXATION

TO: Representative Cindy Evans, Chair, Representative Nicole E. Lowen, Vice Chair, and Members, Committee on Water and Land

FROM: Peter K. Mattoon, Partners in Care, Advocacy Committee Co-Chair

Hearing: Monday, February 3, 2014; 9:15 am; CR 325

Chair Evans, Vice Chair Lowen, and Members, Committee on Water and Land:

Thank you for the opportunity to testify in **support** of HB 1850, which imposes a conveyance tax on the conveyance of a controlling interest of an entity with an interest in real property in the state. I am Peter K. Mattoon, and I am an Advocacy Committee Co-Chair for Partners In Care (PIC), a coalition of care providers focusing on the needs of homeless persons and strategies to end homelessness

We see HB 1850 as an issue of fairness. When the island of Lanai was sold, no conveyance tax was paid. Yet if a house or a business is sold, the conveyance tax is paid. We feel that it is fair that transfers of real estate via majority stock transfers, like direct transfers of real estate via purchase and sale agreements, should be subject to the conveyance tax. 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 funds from the conveyance tax.

Homelessness is a pressing social crisis, and Hawai'i has the highest rate of homelessness in the nation. Many factors contributing to chronic, individual, and family homelessness. But for many households, especially families, their low income relative to the high cost of living—which is twice the national average—means they can barely make ends meet and risk or actually experience homelessness.

Our member agencies work with many households who have worked hard to get their lives back on track and find employment, yet they struggle to find affordable housing. A two-bedroom apartment at fair market rent costs \$1,671. A minimum wage worker would need to work 177 hours per week, 52 weeks a year for this rent to be affordable (less than 30 percent of their income), or a household would need 4.4 minimum wage workers working full time to make this rent. Unsurprisingly, many of our low-income families are severely cost-burdened. The 2010 Homeless Services Utilization Report found that more than half of homeless families had at least one adult working full or part-time, and that an inability to afford rent was a cause of their homelessness for 56 percent of all homeless families.

We urge your support to close this tax loophole and tax the value of the real estate. This is a fairness issue first. Additionally, the bill would have a beneficial impact on affordable housing and land protection. We need action to create more affordable housing NOW. This bill will help.

Contact PIC Advocacy Co-Chairs: Jenny Lee, jenny@hiappleseed.org, 587-7605; Peter Mattoon, peter.mattoon@catholiccharitieshawaii.org, 527-4745; or Betty Lou Larson, bettylou.larson@catholiccharitieshawaii.org; 585-6983/ 373-0356.

PARTNERS IN CARE c/o Aloha United Way
200 North Vineyard • Suite 700 • Honolulu, Hawaii 96817



**Testimony to the House Committee on Water and Land
Monday, February 3, 2014 at 9:15 A.M.
State Capitol - Conference Room 325**

RE: HOUSE BILL NO. 1850 RELATING TO TAXATION

Chair Evans and Vice Chair Lowen, and members of the committee:

The Chamber of Commerce of Hawaii **opposes** H.B. No. 1850. This bill seeks to impose a conveyance tax for each conveyance of interest in real property.

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.

We are deeply concerned by the manner in which the Conveyance Tax has been and is being applied. 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. It appears that the legislation is targeting transactions involving the sale of interests in entities that have ownership over real property in the state due to the recent sales or changes of ownership of private holdings.

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 along with other uses not related to the Bureau of Conveyances.

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

**HB 1850
RELATING TO TAXATION**

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

FEBRUARY 3, 2013

Chair Evans and Members of the House Committee on Water & Land:

I am Paul Oshiro, testifying on behalf of Alexander & Baldwin, Inc. (A&B) on HB 1850, “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 support the provision in Section 247-3(17) (page 20, lines 12 to 16) to exclude from the conveyance tax transfers of controlling interest between members of an existing, established entity.

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 amendment to exclude 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.

Thank you for the opportunity to testify.



PROTECTING HAWAII'S OHANA, CHILDREN, UNDER SERVED, ELDERLY AND DISABLED

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TO: Representative Cindy Evans, Chair
Representative Nicole Lowen, Vice Chair
Members, Committee on Water and Land

FROM: Scott Morishige, Executive Director, PHOCUSED

HEARING: House Committee on Water and Land
Monday, February 3, 2014 at 9:15 a.m. in Conf. Rm. 325

Testimony in Support of HB1850, Relating to Taxation.

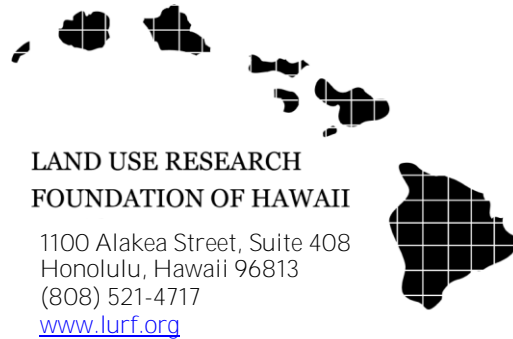
Thank you for the opportunity to provide testimony in **support** of HB1850, which imposes a conveyance tax on the conveyance of a controlling interest of an entity with an interest in real property in the state. PHOCUSED is a coalition of health, housing, human services agencies and individual advocates committed to strengthening policies and programs to support the marginalized and underserved in Hawaii.

Normally, when a house, business or other property is sold in Hawaii, a conveyance tax is paid on the sale. Revenue from the conveyance tax provides funding for a range of critical state needs, such as affordable housing, land preservation, and watershed protection. However, when the island of Lanai was recently sold, Hawaii lost six million dollars in conveyance tax revenue due to a loophole in the current law. It is important to close this loophole in the law so that no future funds are similarly lost.

One of the areas supported by conveyance tax revenue is affordable housing development. Our PHOCUSED member organizations – which represent some of the largest human service providers in Hawaii – regularly see many local families struggling to make ends meet due to the lack of safe and affordable housing in our state. According to the Corporation for Enterprise Development (CFED), over 55% of Hawaii's renters are "housing cost burdened" – paying more than 1/3 of their income to housing costs – which is one of the highest percentages of cost burdened renters in the nation. In addition, Hawaii has one of the highest rates of homelessness in the U.S.

Conveyance tax revenues are the only dedicated source of funding for the Rental Housing Trust Fund (RHTF), which is an effective tool to address Hawaii's affordable housing needs. Since its inception, the RHTF has resulted in 4,567 new affordable rental units for our community. However, current levels of funding for the RHTF are insufficient to meet demand and many projects are ready to be developed, but are waiting on funding in order to proceed. The conveyance tax revenues lost during Lanai's recent sale could have provided additional funds for the RHTF, as well as other critical needs.

Once again, we support HB1850 and believe that all transfers of real estate should be subject to conveyance tax – whether they occur via majority stock transfer or through direct transfers of real estate via purchase and sale agreements. We appreciate the opportunity to submit testimony on this issue. If you have any questions, you may contact PHOCUSED at (808) 521-7462 or via e-mail at admin@phocused-hawaii.org.



February 3, 2014

Representative Cindy Evans, Chair
Representative Nicole E. Lowen, Vice Chair
House Committee on Water & Land

Comments and Concerns Regarding HB 1850, Relating to Conveyance Tax; Controlling Interest Transfer (Imposes a conveyance tax on the conveyance of a controlling interest of an entity with an interest in real property in the State. Applies to conveyances occurring after June 30, 2015).

Monday, February 3, 2014, 9:15 a.m., in Conference Room 325

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 1850. This bill proposes to impose a conveyance tax on the conveyance of a controlling interest of an entity with an interest in real property in the State. The proposed measure would apply to conveyances occurring after June 30, 2015.

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 1850, and must request that this bill be held in Committee.

Background.

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.

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 [“NARF”]) 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, or need identified in the Act.

LURF’s Position.

1. Revenues from the proposed imposition of the conveyance tax on transfers of controlling interests in entities are unnecessary and unwarranted.

Last year, during the 2013 Regular Session, sufficient general funding for the NARF was successfully earmarked by this Legislature. Standing Committee Report No. 928 dated March 11, 2013, and relating to HB 200, HD1 (the State Budget for FY2014-2015), confirms that the Committee on Finance, recognizing the importance of projects that **preserve the State’s natural resources, appropriated \$8.5 million** to the NARF, making any supplemental funding through the Conveyance Tax revenue collected pursuant to this proposed bill unnecessary, as well as unwarranted.

a. Application of the Conveyance Tax revenue collected pursuant to this bill to increase the NARF and other similar funds is arguably illegal and in violation of HRS Sections 37-52.3 and 37-52.4.

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.

b. Supporting Legislation.

During the 2013 legislative session, HB 504 (now Act 130 (SLH 2013)) also directly addressed the issue relating to use of special funds and reinforced the requirement that special and revolving funds must reflect a clear link between the program funded and the source of revenue. The principles underlying Act 130 are clear, and the measure settles without question, the fact that special, revolving, and trust funds must, amongst other things:

1. **serve a need** as demonstrated by the purpose of the program to be supported by the fund; the scope of the program; and an **explanation of why the program cannot be implemented successfully under the general fund appropriation process**; and
2. **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 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.**

As applied to this case, Act 130 thus makes 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.

Moreover, emphasis is put on the requirement that special funds be supported when and if at all possible, through the general fund appropriation

process rather than through a means removed from the normal budget and appropriation process. As stated above, \$8.5 million was already appropriated for NARF during the 2013 legislative session through HB 200, HD1 (the State Budget for FY2014-2015).

c. **If required, alternative, more appropriate 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:

1. Current and proposed funding support through county board of water supply charges;
2. Funding through voluntary donations by rental car lessors or hotel room guests (e.g., HB 760, HD1, SD1, carried over from the 2013 Regular Session and which proposes to require 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
3. Voluntary contribution programs such as an income tax refund check-off box (which was proposed in 2013 by HB 571 and carried over to the 2014 Regular Session, 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 sufficient general funding and alternative methods to secure revenues for these funds exist, 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.

2. **Transfers of stock are not “conveyances” of real property, and rightfully should not be made subject to the conveyance tax law.** HB 1850 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.

3. **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.
4. **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.
5. **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 1850 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.
6. **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.
7. **Proper and effective implementation of the proposed bill would involve complex, time-consuming, and subjective determinations.** Despite the inclusion of detailed definitions of terms to be construed in HRS Chapter 247, as a practical matter, in order that the proposed measure be properly and effectively administered and enforced, determinations as identified in the bill must still 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 or not 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.

For the reasons stated above, LURF respectfully recommends that **HB 1850 be held in this Committee.**

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