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TAX FOUNDATION OF HAWAII

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SUBJECT: CONVEYANCE, Transfer of a controlling interest

BILL NUMBER: SB 122; HB 345 (Identical)

INTRODUCED BY: SB Chun Oakland and 3 Democrats; HB by Nishimoto

EXECUTIVE SUMMARY: This measure attempts to overhaul the conveyance tax by making it applicable to transfers of controlling interests in entities that own realty as well as conveyances of realty. We observe that this tax was never intended to be a major revenue source, but now is imposed at rates high enough to motivate taxpayers to plan around it, which planning is now motivating lawmakers toward an equal and opposite reaction, namely this bill. At present, however, the infrastructure set up to capture necessary information and collect the tax, while adequate for a documentary transfer tax that it was, is not adequate to enforce the overhauled version in this bill.

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 sections 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, 2015 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, or having the department of taxation brought in to review more complex exemptions or documents. 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, it would be a stretch for the department of taxation which has had only limited involvement with this tax before, and the bill itself doesn't appear to give taxpayers or the agencies guidance as to how taxpayers are supposed to be reporting, or how agencies are supposed to be collecting the tax on the more complex transactions. Suppose, for example, company A holding real property merges into company B, with company B surviving. At present, the transaction is evidenced by a certificate of merger filed with the department of commerce and consumer affairs and nothing needs to be filed at the bureau of conveyances. If the intent is now to require the certificate of merger to be filed at the bureau which would make the transaction subject to the conveyance tax, it is not delineated in the measure.

If the ideas in this bill are to move forward, more serious thought should be given to reporting and compliance issues, as well as enforcement, so as to come up with a fully featured tax.

Digested 1/30/15



CATHOLIC CHARITIES HAWAII

TESTIMONY IN SUPPORT OF HB: 33: RELATING TO TAXATION

TO: Representative Mark J. Hashem, Chair, Representative Jo Jordan, Vice Chair, and Members, Committee on Housing

FROM: Trisha Kajimura, Social Policy Director, Catholic Charities Hawai'i

Hearing: Monday, February 2, 2015; 8:30 am; CR 325

Chair Hashem, Vice Chair Jordan, and Members, Committee on Housing:

Thank you for the opportunity to testify in **support** of HB 345, which imposes a conveyance tax on the conveyance of a controlling interest of an entity with an interest in real property in the state.

Catholic Charities Hawai'i (CCH) is a tax exempt, non-profit agency that has been providing social services in Hawai'i for over 60 years. CCH has programs serving elders, children, developmentally disabled, homeless and immigrants. Our mission is to provide services and advocacy to the most vulnerable of the people in Hawai'i. Catholic Charities Hawai'i has a long history of working on housing issues and solutions to homelessness. We strive to help people live in dignified circumstances and reach their full potential.

When the island of Lanai was sold, no conveyance tax was paid. Yet if a house or a business is sold "for cash", the conveyance tax is paid. We feel that it is only fair that non-cash transfers of real estate should also 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.

It is not clear to us if sales by Real Estate Investment Trusts (REITs) would be covered by this bill. We urge that REITs be covered by the conveyance tax. This is a major vehicle used by investors to buy and sell real estate. Again, it is a fairness issue.

The need for affordable housing is severe and all who buy/sell real estate, via any vehicle, should pay their fair share into the conveyance tax. 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 among the US states. The Hawaii Housing Planning Study of 2011 found that an estimated 13,000 rental units need to be built by 2016. The Rental Housing Trust Fund with proceeds from the conveyance tax has a proven record of producing affordable rentals, but additional resources are needed to build the 13,000 needed rental units.

Thank you for the opportunity to testify. Please contact me at (808) 527-4810 or trisha.kajimura@catholiccharitieshawaii.org if you have any questions.



Testimony of The Nature Conservancy of Hawai'i
Supporting H.B. 345 Relating to Taxation
House Committee Housing
Monday, February 2, 2015, 8:30AM, Room 329

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. 345. 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 great 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 have recently experienced prolonged 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 bill.

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To: The Honorable Mark J. Hashem, Chair
and Members of the House Committee on Housing

Date: Monday, February 2, 2015
Time: 8:30 A.M.
Place: Conference Room 329, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 345, Relating to Taxation

The Department of Taxation (Department) appreciates the intent of H.B. 345 and provides the following information and **comments**.

H.B. 345 makes significant changes to the conveyance tax. Particularly, H.B. 345 imposes a conveyance tax when there is a transfer of a controlling interest in an entity that has an interest in real property. H.B. 345 also taxes certain transactions, currently exempt from the conveyance tax, 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 sets forth what may constitute "consideration" under the law. The Department suggests including the deleted language from section 247-2, HRS, into the new definition of "consideration" proposed in section 247-A so that the amendments will not be construed as a change in the State's position.

Second, the Department is not certain that the proposed confidentiality requirements in section 247-D are necessary, as they do not exist in the law today and may interfere with the Department's or the Department of the Attorney General's attempts to enforce compliance. The Department suggests the addition of an exception to the confidentiality requirements for the

purposes of law enforcement. If the intent of this provision is to keep controlling interest transfers confidential in other settings, 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. Because much of the information on the Conveyance Tax Certificate is published by the respective 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 "wilfully" 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 defines "wilfully" in the context of other 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**.

DAVID Y. IGE
GOVERNOR OF HAWAII



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

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**Testimony of
CARTY S. CHANG
Acting Chairperson**

**Before the House Committee on
HOUSING**

**Monday, February 2, 2015
8:30 AM
State Capitol, Conference Room 329**

**In consideration of
HOUSE BILL 345
RELATING TO TAXATION**

House Bill 345 proposes to impose a conveyance tax on the transfer or conveyance of a controlling interest of an entity with an interest in realty in the State. **The Department of Land and Natural Resources (Department) supports the intent of this bill to the extent that the bill would increase the amount of conveyance tax revenues deposited into the Department's Natural Area Reserve Fund and Land Conservation Fund.**

The Natural Area Reserve Fund supports the Natural Area Partnership Program, the Natural Area Reserves, the Watershed Partnerships Program, and the Youth Conservation Corps. These programs protect Hawaii's invaluable ecosystems and forested watersheds.

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.



**Testimony to the House Committee on Housing
Monday, February 2, 2015 at 8:30 A.M.
Conference Room 329, State Capitol**

RE: HOUSE BILL 345 RELATING TO TAXATION

Chair Hashem, Vice Chair Jordan, and members of the committee:

The Chamber **opposes** HB 345, which imposes a conveyance tax on the conveyance of a controlling interest of an entity that has 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.

We **oppose** this bill as it provides disincentive to investment and possibly incurs double taxation to tax payers for complex real estate transactions. In essence this bill is taxing the transfer of stock in the conveyance tax rather than other parts of the tax code. It will discourage investment in real estate and could hurt every industry from housing, agriculture to tourism.

Furthermore, our larger concern lies with the reliance on the conveyance tax for more than what it was originally intended to do. The Conveyance Tax was created to cover the administrative costs of recording the real estate transactions, such as those performed by the Bureau of Conveyances. 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. Thirty per cent in each fiscal year shall be paid into the **Rental Housing Trust Fund** established by section 201H-202; and
3. Twenty-five per cent in each fiscal year 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;



Chamber of Commerce HAWAII

The Voice of Business

- 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; . . .”

While we strongly support the various programs receiving funding from the revenues generated by the Conveyance Tax, we do not believe that the conveyance tax is the appropriate means to fund these programs. 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.



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TESTIMONY FOR HOUSE BILL 345, RELATING TO TAXATION

House Committee on Housing
Hon. Mark J. Hashem, Chair
Hon. Jo Jordan, Vice Chair

Monday, February 2, 2015, 8:30 AM
State Capitol, Conference Room 329

Honorable Chair Hashem and committee members:

I am Kris Coffield, representing IMUAlliance, a nonpartisan political advocacy organization that currently boasts over 300 local members. On behalf of our members, we offer this testimony in support of House Bill 345, relating to taxation.

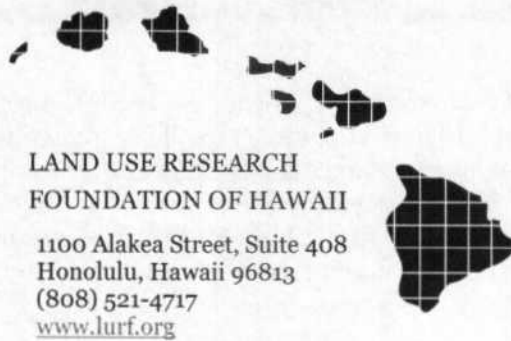
It's the ultimate billionaire's tax loophole. Almost everyone who sells a home, condo, or other real estate in Hawai'i is subject to a conveyance tax based on the selling price. The tax rate is a sliding scale, going from one-tenth of 1 percent of the sales price for an owner-occupied home selling for under \$600,000 to 1.25 percent for some sales over \$10 million.

Yet, today, a working class homeowner in our state pays more tax on a condo sale than David Murdock and Larry Ellison paid to transfer ownership of 98 percent of Lana'i, a \$600 million deal organized as a sale of corporate stock in the Murdock-controlled entities that held title to the 88,000 acres. Why? Because the conveyance tax is not imposed on the transfer of ownership of a business entity that is equivalent to the sale of an interest in real property.

If the island had sold as a standard real estate transaction, the state's conveyance tax cut would have been \$6 million. Other transactions that have avoided the conveyance tax by putting the land into a corporation include the sale of Ala Moana Center, Victoria Ward Centers, and the Kahala Hotel. Conveyance taxes support critical state programs like the Legacy Land Conservation Fund, rental housing trust fund, and natural area reserve fund, with the balance disbursed to the general fund. We must ask what's more important, billionaire's fortunes or helping Hawai'i's poor and preserving our environment?

Economic equality must be one of our state's top priorities. We cannot let billionaire's tax boondoggles to undermine our commitment to fiscal fairness and financial justice. Mahalo for the opportunity to testify in support of this bill.

Sincerely,
Kris Coffield
Executive Director
IMUAlliance



LAND USE RESEARCH
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LATE

February 2, 2015

Representative Mark J. Hashem, Chair
Representative Jo Jordan, Vice Chair
House Committee on Housing

Comments and Concerns Regarding HB 345 Relating to Taxation; Conveyance Tax; Controlling Interest Transfer - Imposes a conveyance tax on the conveyance of a controlling interest of an entity that has an interest in real property in the State. Applies to conveyances occurring after 06/30/2015. Effective 07/01/2015.

HSG Hearing: Monday, February 2, 2015, 8:30 a.m., in Conference Room 329

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 345. 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 345**, and must request that this bill **be held** in Committee.

Background. The bill does not include a purpose section; however, it is believed that the bill is intended to raise more revenue for the various programs funded by the conveyance tax.

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 impose conveyance taxes 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. Certain revenues from the proposed imposition of the conveyance tax on transfers of controlling interests in entities are unnecessary and unwarranted and have been recommended for discontinuance by the State Auditor.

Two years ago, 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 which lack a clear nexus 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 that 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 345 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 that benefit from conveyance tax revenues should be exempted from this bill.** It is ironic and unfair that the entities that 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 that 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 345 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 this bill 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 345 be held in this Committee.**

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