

SB712

Measure Title: RELATING TO TAXATION.

Report Title: Income Tax Law; HARPTA; Resident Person

Description: Amends the Hawaii Real Property Tax Act by removing foreign partnerships, foreign limited liability companies, and foreign limited liability partnerships from the definition of "resident person".

Companion:

Package: None

Current Referral: CPH, WAM

Introducer(s): DELA CRUZ

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To: The Honorable Rosalyn Baker, Chair
and Members of the Senate Committee on Commerce, Consumer Protection, and Health

Date: Thursday, January 31, 2019
Time: 9:30 A.M.
Place: Conference Room 229, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 712, Relating to Taxation

The Department of Taxation (Department) offers the following comments on S.B. 712 for the Committee's consideration.

S.B. 712 amends the Hawaii Real Property Tax Act (HARPTA) by removing foreign partnerships, foreign limited liability companies, and foreign limited liability partnerships from the definition of "resident person" in Hawaii Revised Statutes (HRS) section 235-68.

HARPTA requires every buyer/transferee of real property to withhold and pay to the Department seven and one-quarter per cent of the amount realized on the disposition of Hawaii real property. Sellers/transferees who are Hawaii resident persons, as defined in section 235-68, HRS, are exempt from this requirement. Removing foreign partnerships, foreign limited liability companies, and foreign limited liability partnerships from the definition of "resident person" would make them ineligible for the exemption from the withholding of tax on the disposition of Hawaii real property.

If the Committee's intent is to disallow these foreign entities from using the HARPTA withholding exemption, the Department recommends that the Committee insert language expressly stating that the following entities are not "resident persons" under this statute: foreign partnerships operating under section 425-3, HRS; foreign limited partnerships operating under section 425E-901, HRS; foreign limited liability partnerships operating under section 425-161, HRS; and foreign limited liability companies operating under section 428-1001, HRS. This will help clarify and effectuate the bill's legislative purpose.

The Department also notes that this bill would apply to taxable years beginning after December 31, 2018. The Department respectfully requests that the applicable date be postponed until December 31, 2019, to allow time for the Department to make the necessary changes to forms and instructions.

Thank you for the opportunity to provide comments.

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SUBJECT: INCOME, Remove Foreign Entities from HARPTA Resident Definition

BILL NUMBER: SB 712

INTRODUCED BY: DELA CRUZ

EXECUTIVE SUMMARY: This measure removes foreign entities from the definition of “resident” under Hawaii’s law requiring nonresident sellers to withhold a percentage of the gross proceeds of a real estate transaction. Thus, foreign entities would be required to withhold even if they are owned and operated in Hawaii. This measure undoes changes to the law that were made in 1991 and may raise constitutional concerns.

SYNOPSIS: Amends HRS section 235-68 to delete from the definition of “resident person” foreign entities that are registered with the DCCA to do business in Hawaii.

EFFECTIVE DATE: Upon approval, shall apply to taxable years beginning after December 31, 2018.

STAFF COMMENTS: The withholding provision at issue, HRS section 235-68, commonly known as HARPTA, was enacted as Act 213, SLH 1990. At the time, HARPTA excused from withholding only to domestically organized corporations, partnerships, and similar business entities.

It turns out that in the very next legislative session, the Department of Taxation introduced an administration measure, TAX-17 (1991), to add to the definition of resident person any business entities that were lawfully registered with the DCCA. That measure became Act 279, SLH 1991. In its testimony before the Legislature, the Department explained:

The bill adds any foreign corporation certified or authorized to transact business in Hawaii to the definition of a resident person. Since these corporations are registered with the department of commerce and consumer affairs, they should be treated in a manner similar to resident corporations.

Testimony of Richard F. Kahle, Jr., Director of Taxation (Mar. 27, 1991); Testimony of Richard F. Kahle, Jr., Director of Taxation (Feb. 19, 1991);

The Foundation’s testimony in 1991 also highlighted another reason:

Finally, it should be noted that the amendment to the definition of a resident person recognizes that there are companies which while not incorporated under Hawaii law, nevertheless make Hawaii their home.

Testimony of Tax Foundation of Hawaii (Mar. 25, 1991); Testimony of Tax Foundation of Hawaii (Feb. 7, 1991).

In addition, the Commerce Clause of the U.S. Constitution informs analysis of taxes affecting business such as the General Excise Tax, *In re Hawaiian Flour Mills, Inc.*, 76 Haw. 1, 868 P.2d 419 (1994), and the Liquor Tax, *Bacchus Imports, Ltd v. Dias*, 468 U.S. 263 (1984).

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), which the Hawaii Supreme Court also follows when evaluating Commerce Clause tax issues, *In re Baker & Taylor, Inc.*, 103 Haw. 359, 82 P.3d 804 (2004), establishes that a state tax must pass a four-part test to survive scrutiny under the Commerce Clause:

1. The taxed activity has a substantial nexus to the taxing state;
2. The tax is fairly apportioned to activity in the state;
3. The tax does not discriminate against interstate commerce; and
4. The tax is fairly related to services provided by the state.

Bacchus Imports, Ltd v. Dias, 468 U.S. 263 (1984), called it a “cardinal rule of Commerce Clause jurisprudence” that “[n]o State, consistent with the Commerce Clause, may ‘impose a tax which discriminates against interstate commerce ... by providing a direct commercial advantage to local business.’” *Id.* at 268 (quoting *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 320 (1977)).

In *Bacchus*, the taxing statute facially discriminated against interstate commerce. *Bacchus* invalidated an exemption from Hawaii Liquor Tax on sales of locally produced okolehao and fruit wine. The bill before this Committee imposes a withholding requirement when an entity organized outside of Hawaii sells real property but does not impose the requirement when an entity organized in Hawaii sells real property. That would be a burden on business being conducted by an entity solely because it is organized outside of Hawaii, which could be seen as facial discrimination against interstate commerce. For that reason, the bill should be carefully analyzed for compliance with this constitutional provision if it is to move forward.

Digested 1/26/2019

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Submitted on: 1/26/2019 9:50:59 AM

Testimony for CPH on 1/31/2019 9:30:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Lois Crozer	Individual	Support	No

Comments: