INTRODUCTION
TO
HARPTA
LAW

Local Hawaii Real Estate

Honesty • Integrity • Commitment

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Purpose

The purpose of this hand out is to help introduce nonresident owners to the HARPTA Law. It is based on is based on Hawaii Tax Information Release No. 2002-2. A copy of this Release may be viewed at: http://www.state.hi.us/tax/pubs/htn/htn02-09.pdf

Legal Notice

Local Hawaii Real Estate and its affiliated Brokers and Salespersons are Licensed Real Estate professionals who are REALTORS®. We always recommend that you contact Hawaii Licensed Law and Financial professionals such as Attorneys or CPA's in all cases where you may need legal or tax advice.

What is HARPTA?
HARPTA is the short name we use to refer to the Hawaii Real Property Tax Law on nonresidents. Under HARPTA, an estimate of the transferor's (owner's) capital gains tax that will be due Hawaii is withheld at closing and paid to the Hawaii Department of Taxation as a "prepayment" of the tax a non-resident seller owes on the sale of real estate. Prior to HARPTA, the State of Hawaii had no lawful way of collecting a tax unless the nonresident owner filed a Hawaii income tax return for the year of the sale.

How does HARPTA define nonresident?
A nonresident owner for purposes of HARPTA is basically an owner who does not file a Hawaii resident tax return.

How is HARPTA enforced?
The HARPTA Law requires a buyer to withhold 5% of the sales price and send it to the Hawaii Department of Taxation as a **"prepayment"** of the tax a nonresident transferor or property owes on the sale of real estate. Under the law, it is the Buyer's obligation to withhold the tax. In practice, provided that instructions are given to escrow, the amount to be withheld can be shown on the settlement statement and the Escrow Officer would remit the withholding amount to the Department of Taxation on behalf of Seller and Buyer, unless one of the specified exclusions apply.

The Following are the most common exceptions:

a) There is no taxable gain on the sale and an approved N-288B form has been received from the state.
b) There are insufficient proceeds from the sale to pay the withholding and an approved N-288B form has been received from the state. If some proceeds are available and there has been gain, the state may adjust the withholding to a lesser amount.
c) The capital gains tax due on the sale of a personal residence has been excluded by having owned and occupied the property for two out of the past five years and a N-289 form has been completed.
d) In the year prior to the sale the property was used as a primary residence and the sales price is $300,000 or less and the seller has completed a N-289 form.
e) The owner is in the military and selling their primary residence and has completed a N-289 form.
f) The owner conducts an IRC 1031 tax-deferred exchange.

What is an IRC 1031 tax-deferred exchange?
Section 1031 of the Internal Revenue Code (IRC) provides for the deferment of capital gains taxes realized on the sale of investment real estate when it is exchanged for other investment real estate. Under IRC section 1031, if you sell investment real estate and buy more expensive investment real estate within a prescribed time frame, you can defer capital gains taxes on the property you are selling.

Is there a web site with information about 1031 of the Internal Revenue Code?
The Internal Revenue Service URL is: http://www.irs.gov/irb/2008-10_IRB/ar12.html

Is Hawaii tax law for the sale of a personal residence similar to the Federal Taxpayer Relief Act of 1997?

Current federal tax policy allows an owner to exclude up to $250,000 of gain (single) or up to $500,000 of gain (married) providing they have owned and occupied a property for at least two out of the past five years. Lower exclusions may be allowed under certain circumstances if the owner occupancy time frame has been less than two years. You may complete a from A N-289 form should this law apply to you.

What if the collected amount is more than you owe?

If the 5% withholding is more than a transferor owes, the transferor should file a Hawaii form N-288C after closing. The State of Hawaii Department of Taxation has no provision we know of for filing prior to closing so the correct or exact amount will be withheld.

<u>The HAPTA Law states there are three ways that a transferor may apply for a refund of amounts withheld that exceed the transferor's tax liability</u>.

1) a transferor may apply for a refund when the transferor files an income tax return for the year.
2) a transferor may file Form N-288C (Application for Tentative Refund of Withholding on Dispositions by Nonresident Persons of Hawaii Real Property Interests) to adjust the amount of tax withheld and receive an early refund of the amount that exceeds the transferor's tax liability for the transaction. The transferor must present sufficient information on Form N-288C regarding the basis; sales price, and gain on the property as determined by Hawaii income tax law. After reviewing Form N-288C, the Department will refund the amount withheld and paid over to the Department, which exceeds the tax on the gain. The transferor/taxpayer must still file a tax return after the end of the tax year, report the entire income for the year (from other sources as well as the transaction), and pay any additional tax due on the income or request a refund.
3) a transferor who is closing out the tax year in the State (i.e., leaving the State and has no other sources of income in the State) may file a short year tax return. Additionally, a transferor may be a one-time taxpayer because the entire Hawaii tax liability arises solely out of the single transfer of real property located in the State. This transferor, who is not conducting business in the State and does not have and will not have during the rest of the year any other taxable income in the State, also may file an early short year tax return.

What if there are insufficient proceeds from the sale to pay the withholding or if there is a loss on the sale rather than a gain?

The withholding may not be required if there are insufficient proceeds from the sale or if there has been a capital loss rather than a capital gain. When either of these occurs, escrow will not close the transaction until a Hawaii form N-288B has been approved by the state (unless the seller agrees to pay the withholding). If the sale creates a capital

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loss or the proceeds available are insufficient, the owner must submit appropriate supporting documents to the state, these must include (as applicable):

a) a copy of the closing statement when the property was purchased;
b) documentation showing depreciation that has been claimed;
c) documentation for any capital improvements;
d) documentation for deferred gain from any prior sale(s) that adjusted the owner's buying basis;
e) an estimated closing statement prepared by escrow.

To allow time for approval, the N-288B form must be submitted to the State of Hawaii Department of Taxation at least **ten days** prior to closing. Since an estimated closing statement prepared by escrow has to accompany the N-288B form, the N-288 from is usually submitted relatively late during the escrow process. If the N-288B form is rejected, there is usually insufficient time to submit a revised form and still meet the scheduled closing date. We have been informed N-288B rejections are quite common because of insufficient documentation.

Local Hawaii Real Estate recommends that all owners have a Hawaii Licensed CPA or professional tax advisor prepare their N-288B form to document a capital loss so it will not be returned for insufficient documentation.

GET Tax on Rental Property
The N-288B form has a section where the owner indicates if the property has been a rental and if so, it wants the owner's Hawaii General Excise Tax (GET) number for the property. If you have not been paying the Hawaii GET on your rental income, you may have to pay your past GET and applicable penalties with interest in order to have your form N-288B approved.

Where I can find specific HARPTA forms?
Online: www.state.hi.us/tax/a1_b3_6harpta.htm

More Forms and other tax information are available at the State of Hawaii Department of Taxation website: www.state.hi.us/tax.

To request a form by mail or fax, you may call the State of Hawaii Department of Taxation Taxpayer Services Form Request Line at 808.587.7572, or toll-free at 800.222.7572.

What if I want to talk to some one?
More Hawaii State tax information may be found at:
Tel: 808.587.4242
Tel: 800.222.3229 (Toll- Free)
Telephone for the Hearing Impaired: 808.587.1418 or 800.887.8974 (Toll- Free)
Fax: 808.587.1488