Special Reports

-Hawaii Real Property Tax Law (HARPTA)-

HARPTA

NOTE: This paper is based upon Hawaii Tax Information Releases #90-14 and #91-07 as well as input from Ms. Linn Garcia, Income Tax Specialist at the Hawaii Department of Taxation Technical Section. The questions and answers are designed to help nonresident (absentee) owners understand the Hawaii Real Property Tax (HARPTA) Law.

NOTE: Neither Locations LLC nor any of its agents or employees is licensed to provide either legal or tax advice. Licensed professionals such as tax attorneys or CPAs should be consulted for legal or tax advice.

1. What is HARPTA?

HARPTA is an acronym for the Hawaii Real Property Tax Law. **HARPTA is not a tax**. This is a common misunderstanding. HARPTA was enacted to provide a means for the state to collect capital gains taxes from absentee owners. HARPTA is very similar to laws passed by several other states as well as to a federal law that applies to non-US citizens that sell real estate. Under HARPTA, an estimate of the owner's capital gains taxes is withheld at closing. Prior to HARPTA, the state had no means of collecting such taxes unless the absentee owner filed a Hawaii income tax return for the year of the sale.

Some absentee owners are exempt from the HARPTA law. However, the fact that an owner may be exempt from the HARPTA law does not also exempt the owner from paying state capital gains taxes that may be due Hawaii.

2. How much is collected under the HARPTA law?

The amount collected under the HARPTA law is a **flat 7.25% of the sales price**. Hawaii has determined that 7.25% of the sales price provides a reasonable approximation of the capital gains tax that may be due Hawaii from the sale.

3. What is the actual Hawaii capital gains tax?

Hawaii taxes gain realized on the sale of real estate at 7.25%. Gain is determined largely by appreciation, how much more valuable a property is when sold compared to the price paid when it was purchased. Other factors in determining gain are: (a) capital improvements made while owning the property (including purchasing the fee); (b) depreciation claimed while owning the property; and (c) any deferred gain from a prior sale that was rolled over into the property.

4. If the collected amount is too large, how do you obtain a refund?

If the HARPTA withholding is too large, the owner files a Hawaii form N288C after closing. Refunds normally take 4-6 weeks except during the tax season. Hawaii has no provision for filing a form prior to closing so the correct amount will be withheld.

5. What if there are no proceeds from the sale to pay the HARPTA withholding?

HARPTA withholding is not required if there are no proceeds from the sale. However, escrow will normally not close such a transaction until a Hawaii form N288B has been approved by the state. The state requires the N288B form to be submitted to them at least ten days prior to closing for approval. Accompanying the form must be an estimated closing statement for the sale prepared by the escrow office showing that there will be no proceeds to the owner.

NOTE: The N288B form has a section where the owner indicates if the property has been a rental and if so, the owner's Hawaii General Excise Tax (GET) number for the property. If you have not been paying Hawaii GET on your rental receipts, you may have to pay past GET plus interest in order to have your N288B form be approved.

6. What if there is a loss on the sale rather than a gain?

If the sale creates a capital loss for the owner rather than a capital gain, all the comments including the note under paragraph #5 also apply. However, the owner must also submit supporting documentation to show that there will be a capital loss. The supporting documentation must include (as applicable): a copy of the closing statement when the property was purchased, documentation showing depreciation that has been claimed, documentation for any capital improvements, and documentation for deferred gain from any prior sale(s) that adjusted the owner's buying basis. Documentation is also required for question #7 if applicable.

For most owners, we recommend a CPA or tax advisor provide assistance in preparing the N288B form. It is not unusual for the state to reject applications because of insufficient documentation. The N288B form can not be submitted early on, as one of the enclosures needs to be an estimated closing statement prepared by the escrow office. There have been situations where owners paid HARPTA withholding when they had no gain merely to be able to close their transactions without a delay. The owners were reimbursed after the sale, however, they could have avoided it had they submitted a better package prior to the sale.

7. Is Hawaii tax law similar to the Taxpayer Relief Act of 1997?

Yes. This federal law 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.

8. How does an owner obtain the HARPTA forms?

The various forms associated with HARPTA can be obtained from the state, refer to the last page of this report for an address. Most real estate companies should also have them available. Locations LLC routinely provides HARPTA forms to our clients.

9. What defines a nonresident?

A nonresident owner for purposes of HARPTA is an owner who does not file a Hawaii resident tax return. There are some exceptions that apply largely to individuals who travel extensively. These exceptions lie beyond the scope of this paper, refer to the last page of the report for a source to contact for additional information.

10. Does HARPTA apply to military members?

Military members are exempt from the 5% HARPTA withholding at closing if the sale involves their primary residence and if they are being transferred from Hawaii under military orders. For purposes of HARPTA, a military member is defined as someone on active duty when their Hawaii property closes. Even though HARPTA may not apply, the military member may still owe Hawaii capital gains taxes.

11. What happens if a military member rents their Hawaii home rather than selling it?

Once the Hawaii home has been rented, it becomes investment real estate and HARPTA applies.

12. Are there any exceptions to the HARPTA law?

The HARPTA law does not apply if:

a. There is no taxable gain on the sale and an approved N288B form has been received from the state of Hawaii.

b. The owner conducts an IRC 1031 exchange.

c. There are insufficient funds from the sale to pay the withholding amount and an approved N288B from has been received from
the state of Hawaii.

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.

NOTE: Even though the HARPTA law may not apply, capital gains taxes may still be due the state. This particularly applies to the exceptions in
12.c and 12.d.above.

13. What do you mean by "no taxable gain?"

No taxable gain applies when there is a loss on the sale rather than a gain. No taxable gain may also involve transfers of property incident to a divorce, as a gift, or as an inheritance.

14. What do you mean by an IRC 1031 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.

15. How is HARPTA enforced?

The HARPTA law makes the buyer responsible for paying the HARPTA withholding if appropriate instructions are not provided to the escrow company by the seller. Therefore, the Escrow Company will automatically withhold 7.25% of the sales price unless the seller can document that no such withholding is required.

16. Where can I obtain additional information?

The state has a website at Department of Taxation that contains a host of information on Hawaii taxes. The various HARPTA forms can be downloaded from the site. Insert HARPTA in the search block.

The law itself is short and basic; however, interpretations are very complex, particularly for individuals who travel frequently making their residency questionable. Income Tax Specialists at the Technical Section provide assistance to the public. We have found them to be very cooperative and generous with their time. They may be reached at:

State of Hawaii Department of Taxation
Technical Section
P.O. Box 259
Honolulu, HI 96809-0259
(808) 587-4242

Toll free number: 1(800) 222-3229

17. Explain gain further; how does it differ from equity?

Many owners mistakenly use these terms interchangeably. They are completely different. Gain is the profit received on the sale of a property. It establishes the basis for both federal and state capital gains taxes. Equity is the value remaining in a property after paying off the mortgage (and any other liens). Equity is the amount of money you will receive from the sale before paying the costs to sell.

Your mortgage balance impacts upon equity and what you'll net out of the sale of a property but has nothing to do with gain. Your gain on any specific property is the same regardless of whether you own the property free and clear or have a sizable mortgage balance. For example, assume you own property worth $250,000 free and clear or without a mortgage. If you were to sell the property and your closing costs were $20,000, you would net $250,000 less the $20,000 in closing costs or $230,000. If you had refinanced this same property and had a mortgage balance of $200,000, you would net $250,000 less the $200,000 mortgage balance less the $20,000 in closing costs or $30,000. However, your gain in either case would be the same.

Gain is determined largely by appreciation, how much more valuable a property is when you sell it compared to the price you paid when you bought the property. Other factors in determining gain: (a) Capital improvements you have made while owning the property (including purchasing the fee). (b) Depreciation you have claimed while owning the property. And (c), any deferred gain you may have had from a prior sale that was rolled over into the property when you bought it

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