

C O P Y

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November 5, 1957

Op. 57-137

Honorable Earl W. Fase
Tax Commissioner
Territory of Hawaii
Honolulu, Hawaii

Attention: Mr. James Morren, Deputy Tax Commissioner

Dear Sir:

You have requested our advice as to the application of the General Excise Tax under the following circumstances:

C, a general contractor, purchased a track of land and subdivided it into twenty-six lots of approximately 5,000 square feet each, installing streets and utilities. In a typical case C thereafter proceeded as follows:

On January 14, 1956, a licensed realtor received from P the sum of 3500 as a deposit on an "offer to purchase" the property described in "the contract set forth below".

On the same day, January 14, 1956, C and P entered into the contract referred to C agreeing to sell and P to buy--"Property located at Pearl City *** containing an area of 5117 sq. ft. more or less and to build 3 bedroom home according to Specification & plan upon approval * * * for the purchase price of \$15,200, to be paid "Down payment \$4900.00 including above initial deposit and balance subject to conventional loan." This contract further provided: "Necessary documents to complete this transaction shall be drawn and duly executed on or before 45 days", "(terms of occupancy)--upon completion of home."

On the same day, January 14, 1956, C dba X Carpenter Shop contracted with P to construct on the lot so purchased a three bedroom dwelling, the work to commence "upon the completion by P of financial arrangement." P was to maintain insurance against loss by fire during construction. P agreed to pay \$10,300 for the work, as follows:

\$2,575 when materials were delivered and work started.
\$2,575 when the roof was on.
\$2,575 when side walls and partitions were up.
\$2,575 upon completion and before occupancy.

Specifications were approved and incorporated in the building contract by reference. It further was agreed that C might rescind the contract if financing arrangements were not completed by P within 45 days.

On February 1, 1956, C deeded the lot to P.

On February 4, 1956, P executed a mortgage to a building and loan

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company 10,300. This document stated that the purpose was "to secure the payment of the moneys advanced by the Mortgagee to the Mortgagors for the improvement of the premises hereby mortgaged by the erection of a home for said mortgagors."

On February 27, 1956, the deed and mortgage was recorded, the deed bearing revenue stamps in the amount of \$17.05.

On February 14, 1956, C made application for a building permit, naming P as owner and "X carpenter Shop" as contractor.

The foregoing shows that C sold and P purchased a lot plus a building contract. The conveyance of the lot before the start of construction was a fundamental part of the transaction since, before construction could commence, the purchaser must obtain financing in the amount of the building contract. It was not contemplated that C would finance the construction and convey the house as part of the realty.

Though C would not have agreed to the sale of the lot without the building contract the \$15,200 price is segregable into two figures: \$4,900 for the lot and \$10,300 for the construction of the house. That is, \$4,900 was earned by the conveyance of the lot, at which time \$10,300 remained to be earned by the construction of the house. As these latter payments were earned the General Excise Tax upon the business of "contracting" applied.

The amount of stamp tax paid the federal government should have been limited to the consideration paid for the realty the title to which was transferred, and should not have included a building which was not in existence at the time of the transfer of title. The excessive payment of stamp tax of course does not change the facts.

The present matter arises under the General Excise Tax Law as it read prior to the amendments made by Act 1, Sp. S.L. 1957. As amended, the law would impose the tax on the builder even if he had completed the house before finding a purchaser. These 1957 amendments are the subject to General Excise Tax memorandum No. 3 and will not be further commented upon here.

Under the law as it stood prior to the amendments the question is: How much of the gross receipts was "from the sale of real property" and therefor not included in taxable "gross income", pursuant to section 5444, R.L. 1945. The building contract of course was not real property. Hence only \$4,900 was exempt. The parties could not sell as "real property" the \$10,300 building which did not exist, and which P upon becoming owner of the real property was to finance, and C was to construct for P as owner, in the usual manner.

Section 5448, R.L. 1945, defining "contractor" and section 5455, subsection C, imposing a tax of 2 ½% on engaging in the business of contracting apply to the \$10,300 building contract.

R e s p e c t f u l l y ,

/S/ Rhoda V. Lewis
Deputy Attorney General

Approved:

/s/ Herbert Y. C. Choy
Attorney General