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Op. NO. 62-1

STATE OF HAWAII

Department of the Attorney General

HONOLULU

January 10, 1962

Honorable Earl W. Fase
Director of Taxation
Hale Auha
Honolulu, Hawaii

Attention: Mr. John A. Bell
Deputy Director of Taxation

Dear Sir:

This is in response to your letter requesting our opinion on the following problem:

X Company is a partnership primarily engaged in the business of acquiring, holding, using and leasing its real property for the production of income. A portion of the property, however, has been "sold" by agreement of sale to Y Associates, the purchase price to be paid in at least two installments with interest to be paid on the unpaid balance. Your question is whether the income received by X company as interest payments on account of the agreement of sale is taxable gross income within the meaning of the General Excise Tax Law, Chapter 117, Revised Laws of Hawaii 1955, as amended.

Our opinion is that such interest payments constitute taxable gross income.

R.L.H. 1955, sec. 117-2 defines business to include:

". . . all activities, (personal, professional or corporate) engaged in or caused to be engaged in with the object of gain or economic benefit either direct or indirect, but does not include casual sales."

It is not disputed that the activities of X Company are such as to fall within the terms of that definition. But it is urged by X Company that since it is not engaged in the business of selling land, the agreement of sale transaction is a "casual sale" within the meaning of the exception. we do not think so..

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The partnership business deals primarily and extensively in real estate. The nature of such a business is such that the sale of real estate would not be unexpected nor unrelated nor unusual but rather would be a transaction ". . . within the course of the business." (See In Re Taxes, Gay & Robinson, 40 Haw. 722, at 729.) The fact that such a sale is the only one made by the business venture does not of itself render it a "casual sale" within the meaning of the exception above quoted.

It is further urged by X Company that since section 117-3, R.L.H. 1955 excludes from taxable gross income the "gross receipts . . . from the sale of land in fee simple", the interest income is exempt from taxation because the term "gross receipts" includes all installment payments of both principal and interest made on account of the agreement of sale. We are of the view, however, that as used in that exclusion, the term would exempt only the amount paid as purchase price for the land.

Furthermore, it is our opinion that the interest income arising from the agreement of sale is taxable gross income because the transaction from which it is derived is an executory contract and not a "sale" within the meaning of either of the exceptions provided by sections 117-2 and 117-3, R.L.H. 1955.

"A sale of land is the actual transfer of the title from the grantor to the grantee by an appropriate instrument of conveyance. A 'sale' of property transfers ownership thereof, which includes both title and the right of possession.

. . . .

"An agreement to sell land is a contract to be performed in the future, and if fulfilled, it results in a sale. It is preliminary to a sale but is not a sale in itself. (Ide v. Leiser, 10 Mont. 5, 24 Pac. 695.) Breaches, rescission or release may occur, by reason of which the contemplated sale never takes place. A contract to sell land on the installment plan is an agreement to sell, and not a sale. . . ." (Neponsit Holding Corp. v. Ansorge (1926), 215 App.Div. 371, 214 N.Y.S. 91; Franke v. Fergus County (1926), 76 Mont. 150, 245 Pac. 962.) (Citations added.)

Thompson on Real Property, Vol. 8,
Vendor & Purchaser, p. 460.

The distinction between a "sale" and an "agreement of sale" is clearly illustrated in Smith v. Messner (1952), 372 Pa. 60, 92 A.2d 417. There, the State of Pennsylvania imposed a documentary stamp tax on all instruments of writing whereby any lands, tenements or hereditaments within the Commonwealth or any interest therein were "granted, bargained, sold or otherwise conveyed" to any other person. The State Secretary of Revenue sought to enforce that tax on an agreement of sale of realty upon the theory that the document conveyed equitable interest to the vendee and the document therefore conveyed an interest in land within the meaning of the Realty Transfer Tax Act.

The Supreme Court of Pennsylvania rejected the Revenue Secretary's argument by stating that the agreement of sale does not convey equitable interest to the vendee but rather that, by reason of the contractual agreement of sale between the Parties thereto, the vendee's equitable interest in the property is created by operation of law. The Court held that the agreement of sale was not a taxable document under the tax provision because:

"An agreement of sale is an undertaking to execute and deliver an instrument of conveyance and the latter is something separate and apart from the agreement of sale itself. The words 'or otherwise conveyed' contemplate an executed conveyance and impliedly exclude agreements to convey which are executory in nature with mutual promissory obligations."

Conceivably, however, it may be argued that, broadly construed, the term "sales" includes agreements of sale since they are tantamount to documents of conveyance. But we do not think that the legislature intended to include such business transactions within the exemption provisions of sections 117-2 and 117-3. It is a generally accepted rule of statutory construction that unless it appears by the context or otherwise in the statute that a different sense was intended, words are to be given their ordinarily accepted meaning. (See Hawaii Consol. Ry., Ltd. v. Borthwick, 34 Haw. 269.) Furthermore, it is a rule of construction that exemption provisions be strictly construed against the exemption.

A close look at the facts discloses the following:

The agreement of sale involved here states that "the Sellers agree to sell and the Buyers jointly and severally agree to buy" the parcel of land for a set price upon the satisfaction of all of the covenants and conditions contained in the agreement. Stated otherwise, the agreement of sale

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is a contract binding the Sellers to sell (at a later date) and the Buyers to buy (at the same later date) the land but the sale is to take place only if all of the conditions of the contract are subsequently satisfied. If the Buyers fail to meet their contractual obligations, the Sellers may unilaterally annul the contract, keep all payments made as liquidated damages and dispose of the land "as if (the) agreement had never been made."

Thus, in light of the executory nature of the agreement of sale, it is our opinion that by promising to sell only to the Buyers while the agreement of sale was in force in return for the payment of interest on the unpaid portion of the purchase price agreed upon, X Company thereby invested the capital (the land) of the business in which it was engaged (utilization of land for the production of income) within the meaning of sections 117-2 and 117-3, R.L.H. 1955.

Until the Buyers have fully satisfied all of the covenants and conditions of the agreement of sale and the deed of transfer is executed by the Seller, the agreement of sale is merely an investment in the form of a contract restricting the use of the parcel of land with the object of yielding interest income.

Stated otherwise, the interest income is not derived from the sale of the land (for such a sale would yield no interest but merely the purchase price) but instead from a contractual agreement which calls for the sale of land at some future date subject to the prior fulfillment of certain conditions.

Respectfully,

/s/ Carlos Ramelb

CARLOS RAMELB
Deputy Attorney General

APPROVED:

/s/ Shiro Kashiwa

SHIRO KASHIWA
Attorney General