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August 4, 2010

LETTER RULING NO. 2010-17

[redacted text]
[redacted text]
[redacted text]
[redacted text]

Re: **Ruling Under Hawaii Revised Statutes § 235-7(a)(13)**

Dear [redacted text]:

By letter dated [redacted text], you requested confirmation that any gain realized by the [redacted text] (the "Taxpayers") from the sale of leased fee interests in condominium units to the condominium's association of apartment owners (the "Association") would be excluded from Hawaii state income tax under Hawaii Revised Statutes ("HRS") section 235-7(a)(13).

SHORT ANSWER

Any gain realized by the Taxpayers from the sale of leased fee interests in condominium units to the Association is excluded from Hawaii state income tax under HRS § 235-7(a)(13), including if the Association immediately resells the leased fees to the lessees.

FACTS REPRESENTED BY THE TAXPAYERS

[redacted text] (together, the "Taxpayers") are testamentary trusts that own properties for investment purposes, including the fee interests (the "Leased Fees") in various units of a condominium project (the "Condo Units"). Specifically, [redacted text]. The leasehold interests in all of the Condo Units are held by various lessees who are unrelated to the Taxpayers (the "Lessees").

The Taxpayers will offer the Leased Fees for sale to the Association. If the Association is interested in owning the Leased Fees, it will enter into a purchase agreement with the Taxpayers, and will accept the conveyance of title to the Leased Fees at closing. If, however, the Association is not interested in owning the Leased Fees, it will notify the Lessees that the Leased Fees are available for sale. If Lessee of the respective Condo Unit is interested, the Association will enter into a purchase agreement with the Taxpayers. The Association will then enter into a separate purchase agreement with the Lessee, pursuant to which it will resell the Leased Fee to the Lessee at the same price (plus reimbursement for any additional closing costs incurred in connection with such resale). The Association will direct the Taxpayers to convey title to the Leased Fee directly to the Lessee at closing. Furthermore, the Association's obligation to

perform under its purchase agreement with the Taxpayers will be contingent upon each Lessee's performance under its purchase agreement with the Association.

The Taxpayers may sell the various Leased Fees to the Association at various times, depending on the Lessees' abilities to obtain funds. Moreover, if any gain realized by the Taxpayers in connection with the proposed transaction qualifies for the exclusion under HRS § 235-7(a)(13), the Taxpayers will offer the Leased Fees for sale at an approximately 10% lower price than if the gain is not eligible for the exclusion.

RELEVANT LAW

Section 235-7(a)(13) excludes from Hawaii state income tax "[o]ne hundred per cent of the gain realized by a fee simple owner from the sale of a leased fee interest in units within a condominium project ... to the association of owners[.]"

The legislative history indicates that the exclusion is intended to "motivate lessors to sell their leased-fee interest to lessee owner-occupants" and to "provide residential lessees with an opportunity to be fee simple homeowners in an increasingly expensive and competitive housing market," as well as to "result in voluntary conversion of leasehold to fee simple ownership for residential lessees throughout the state."¹

ANALYSIS & CONCLUSION

Based upon your representations, any gain realized by the Taxpayers from the sale of the Leased Fees to the Association will be excluded from income under HRS § 235-7(a)(13). Because the Taxpayers will sell the Leased Fees to the Association, all statutory requirements are met, and any gain from the transactions will be excluded.

The fact that the Association intends to immediately resell the Leased Fees to the Lessees and intends to direct the Taxpayers to convey title directly to the Lessees rather than itself does not affect the validity of Taxpayers' exclusion of any gain from the sale of the Leased Fees to the Association. In fact, the Association's immediate resale of the Leased Fees to the Lessees and direct conveyance of title appears to be in line with the Legislature's intent in enacting this exclusion.

The conclusion reached in this letter is based on our understanding of the facts that you have represented. If it is later determined that our understanding of these facts is not correct, the facts are incomplete, or the facts later change in any material respect, the conclusion in this letter will be modified accordingly. This ruling also may be subject to change due to future amendments to laws, rules, or official Department positions.

If you have any further questions regarding this matter, please call me at 808-587-5334. Additional information on Hawaii's taxes is available at the Department's website at www.state.hi.us/tax.

¹ Stand. Com. Rep. No. 705 and Stand. Com. Rep. No. 526 (2007)

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Sincerely,

Jacob L. Herlitz
Administrative Rules Specialist

[redacted text]