



STATE OF HAWAII
DEPARTMENT OF TAXATION

P.O. BOX 259
HONOLULU, HAWAII 96809-0259

November 3, 1989

TAX INFORMATION RELEASE No. 89-11

RE: The Administration and Application of the Conveyance Tax Law.

PART I. ADMINISTRATION

Pursuant to a meeting between the Department of Taxation (Taxation) and the Department of Land and Natural Resources (Land), Bureau of Conveyances, to discuss the earlier operational agreement between the two departments on the administration of the Conveyance Tax Law, chapter 247, Hawaii Revised Statutes (HRS), the departments agreed to changes in the administration of the conveyance tax that reflect the departments' current responsibilities. While certain operational changes will affect the public, the intent of the departments is to accommodate, to the extent that they are able to, those persons liable for payment of the conveyance tax. The following administrative procedure with respect to the filing of conveyance tax documents will take effect on November 13, 1989:

Filing of Conveyance Documents. Land shall continue to accept conveyance tax certificates on behalf of Taxation at the Bureau of Conveyances in Honolulu, Hawaii. Land will review the certificates offered by taxpayers for filing to ensure that the information on the certificates is complete. Land is authorized to reject and return incomplete certificates, supporting documents, and remittances for recordation whenever the certificates are not complete. Land will refer taxpayers who require further assistance to Taxation. If further assistance or further action is not required, Land shall accept the documents and remittances and imprint its seal on the taxable document or instrument indicating that the taxes have been paid in full.

Conveyance Tax Exemptions. All exemptions to the conveyance tax shall be approved by Taxation. Consequently, before a taxpayer files a document or an instrument that is exempt from the conveyance tax with the Bureau of Conveyances, the taxpayer must first submit the document or instrument, together with an affidavit for an exemption from the conveyance tax, to the Department of Taxation for approval of the exemption. For the initial transition period, beginning November 13, 1989, exemptions shall be submitted to the Technical Review Office, Room 220, Keelikolani Building, 830 Punchbowl Street, Honolulu, Hawaii. Thereafter, beginning January 1, 1990, exemptions shall be submitted to the Taxpayer Services Branch on the ground floor of the same building and to the district tax offices on the neighbor islands. Because exemptions are strictly construed, if it is not clear on the face of a document that a conveyance is an exempt transaction, a taxpayer seeking to file such a conveyance document is advised to include supporting documentation for the exemption with its submission to Taxation.

In the case of a transfer of a real property interest to or from a trust, the Department of Taxation requests that the taxpayer submit in advance for the Department's review, the affidavit for an exemption and supporting documentation for the exemption. Land may accept for filing without remittance only those documents or instruments imprinted with Taxation's seal approving an exemption.

Taxation also shall be responsible for designing and furnishing all conveyance tax forms, including the conveyance tax certificates, tax exemption affidavit forms, and related instructions for taxpayers and their agents. Additionally, Taxation will answer inquiries concerning the tax and provide taxpayers with assistance in completing the forms. The overall administration for this tax and the audit and collection functions for the tax shall remain with Taxation.

PART II. APPLICATION

In addition to the sharing of responsibilities between Taxation and Land, several common and recurring problems with respect to the imposition of the tax and the eligibility of certain transfers of real property interests for statutory exemptions were discussed by the departments. The Department of Taxation (Department) notes that some of the difficulties are the result of the differing perspectives taxpayers apparently have concerning the application of the Conveyance Tax Law.

Taxpayers must first recognize that the conveyance tax is imposed on the transfer of real property interests. Unlike other taxes, the focus of the conveyance tax is not on income, financial gain, or financial loss. The conveyance tax is triggered if a real property interest is transferred from one or more persons to another person or persons. Thus, a conveyance is taxable under the Conveyance Tax Law unless the conveyance is specifically exempted from the tax under section 247-3, HRS. For example, a mortgage document that transfers a security interest in real property to the mortgagee is exempt under section 247-3(2), HRS, but there is no exemption for conveyances between related entities in the statute.

Secondly, a taxpayer's conveyance tax liability is based on the "actual and full consideration paid or to be paid", which generally is the price of the transferred real property interest. Consideration, however, is not limited to cash but may include any promise, act, forbearance, interest, value, gain, advantage, benefit, or profit offered by one party to another in return for the other party's act or promise. The Department recognizes that real property interests also may be conveyed for consideration other than cash consideration. For example, the consideration underlying the conveyance of a real property interest may include tangible goods, an increase in the value of stock or a partnership interest, a release from or assumption of indebtedness, or other economic benefits. The Department affirms that these transfers are taxable under the Conveyance Tax Law. Moreover, while the measure of actual

consideration for purposes of the conveyance tax is more easily determined when the consideration is paid in the form of cash, a transfer of a real property interest for business purposes occurring without cash consideration or nominal cash consideration is, nevertheless, taxable under the Conveyance Tax Law, and the tax is calculated on the value of the consideration underlying the conveyance.

In a case where the value of the consideration is difficult to ascertain or where there is no or nominal cash consideration paid, the Department will presume that the conveyance is for business purposes and is not a gift (See: item #12 below on gifts). The taxpayer, of course, may rebut this presumption by submitting documentation that the conveyance meets the requirements for an exemption. Additionally, in these instances, the actual and full consideration for the transfer shall be measured by the fair market value of the real property interest that is conveyed unless a taxpayer submits sufficient information which supports an alternate value.

The application of the Conveyance Tax Law to certain transactions is discussed below. Taxpayers should bear in mind that the following situations are intended to provide general guidance on the application of the Conveyance Tax Law and do not control the tax treatment of any specific conveyance. The actual tax consequences with respect to any conveyance shall be determined by the Department based upon the factual circumstances of the conveyance, particularly with respect to any exemption from the tax.

1. Exchange of Real Property Interests.

Unless otherwise exempt, when parties exchange real property interests between themselves, both conveyances which transfer the title of the real property interest from one party to the other are subject to tax. In accordance with section 18-247-1(b), Hawaii Administrative Rules, the tax is imposed upon the fair market value of the property that is conveyed by each deed.

2. Exchange of Real Property, Section 1031, Internal Revenue Code of 1986, (IRC) (Exchange of Property Held for Productive Use or Investment).

When real property is exchanged in accordance with the provisions set forth in section 1031, Internal Revenue Code of 1986, (IRC), the transfer is taxable under the Conveyance Tax Law. A provision of one tax law, such as an exemption, is not applicable to another tax unless the provision is specifically adopted and incorporated in the statute setting forth the other tax. Accordingly, although the section 1031 federal income tax exemption is adopted and incorporated in the Hawaii Income Tax Law, chapter 235, HRS, the exemption is not incorporated in the state Conveyance Tax Law. These exchanges, therefore, are not exempt from the conveyance tax.

3. Conveyance To or From A Corporation.

Generally, a conveyance of a real property interest to a corporation in exchange for shares of its capital stock is subject to the conveyance tax.

Similarly, the transfer of real property by a sole shareholder to a corporation is a conveyance from one entity to another, and, if consideration is present, whether or not an increase in the value of the stock of the corporation is shown, the transfer is a taxable transaction.

Finally, the transfer by a corporation of any real property assets for consideration directly to a shareholder of the corporation, including a transfer upon dissolution of the corporation, is a taxable conveyance.

3a. Transfer of Property, Section 351, Internal Revenue Code of 1986, (IRC) (Transfer to Corporation Controlled by Transferor).

The Department will treat section 351, Internal Revenue Code of 1986, (IRC) conveyances similarly to section 1031, IRC, exchanges. Because there is no provision under the Conveyance Tax Law adopting and incorporating section 351, IRC, or Hawaii income tax exemptions, conveyances of real property to a corporation controlled by the transferor are not exempt from the conveyance tax.

4. Conveyance To or From A Partnership.

A conveyance of a real property interest by a partner to a partnership as a contribution to capital for consideration, is subject to the conveyance tax. Unless a taxpayer can show a different amount of consideration, the tax on the conveyance is imposed on the fair market value of the real property interest contributed.

A distribution by a partnership of a real property interest to a partner for consideration, including a distribution upon dissolution of the partnership, is also subject to the conveyance tax.

5. Foreclosure by Mortgagee.

A conveyance by a defaulting mortgagor to the mortgagee in consideration of the cancellation of the mortgage debt is subject to the conveyance tax. The tax is imposed on the fair market value of the real property interest conveyed to the mortgagee. If, however, the conveying document states that the property is transferred as a release from an indebtedness equal to the amount of the defaulted mortgage, the tax may instead be imposed on that amount.

6. Quitclaim Deed.

A conveyance of a real property interest for consideration under a quitclaim deed is taxable under the Conveyance Tax Law. A quitclaim deed which confirms title that is already vested in the grantee and only corrects a flaw in the title, however, is not subject to the tax. (See: item #10 below on correction deeds.)

7. Agreement of Sale.

An agreement of sale is subject to tax at the time it is filed in the Bureau of Conveyances. When the actual and full consideration of an agreement of sale is calculated, the taxpayer must include, in addition to the price paid for the property, the amount of interest income to be earned throughout the term of the agreement of sale, the amounts of any liens or encumbrances added to the sale, as well as any other forms of consideration.

8. Option Contract or Agreement for the Right of First Refusal.

Option contracts and right of first refusal agreements for purchasing an interest in real estate are preludes to possible conveyances of real property or realty interests. They do not, however, transfer real property or realty interests; accordingly, there is no conveyance tax on these contracts or agreements.

9. Partition Deed.

When owners partition their property, whether by agreement or judicial action so that a common or joint interest in the property is divided into 2 or more distinct portions equal in value to the preceding common or joint interest, the value of each resulting portion may be taxable to the extent of each owner's interest or share prior to the partition. The tax treatment of partition deeds shall be determined and based upon the factual circumstances surrounding the partition of the property interests of the parties.

In any case, if a partition changes the undivided proportionate interest of the owners, the transfer is taxable to the extent of the proportionate change in the value of the property ownership interests. The tax is imposed on the conveyance of any resulting interest that is larger than the original undivided proportionate interest of an owner and is computed upon the consideration paid for the interest in excess of the owner's original share or upon the difference in value between the owner's share prior to the partition and the larger share.

Example. X, Y, and Z each own an undivided 1/3rd interest in Lot 3. X and Y (grantors) each convey for consideration a 1/12th interest to Z (grantee), leaving X and Y each with a 1/4th interest and Z with a

1/2 interest. The grantors together conveyed a 1/6th interest and the grantee received a 1/6th interest, therefore, the transfer is taxable under the conveyance tax on 1/6th of the value of Lot 3, which is paid 1/12th by X and 1/12th by Y.

10. Correction or Confirmation Deed (Assuming the original deed is already recorded.)

Section 247-3(3), HRS, exempts deeds which only confirm or correct a document that was previously recorded or filed. A deed which transfers an interest in property earlier thought to be transferred by the parties, but because of a mistake or other reasons the interest is not transferred, is neither a correction or confirmation deed. This transfer is subject to the conveyance tax.

Correction Deed. There is no tax if the sole purpose of a deed is to correct an error in the description of the parties or the description of the property conveyed and the transaction is made without consideration. This exemption applies only if the real property interest in the correction deed is identical to the property which had been intended to pass with the original deed.

Confirmation Deed. A deed made without consideration for the sole purpose of confirming a prior recorded document is not taxable. This exemption applies only if the following take place: (1) the grantee of the deed of confirmation held or holds record title to the property interest described in the deed of confirmation under a prior deed, (2) the deed of confirmation is made solely for the purpose of making the grantee's record legal title under the prior deed sure and unavoidable, and (3) the grantor of the deed of confirmation had no interest in the property conveyed or held a void or voidable interest in the property conveyed.

11. Exchange or Settlement of Real Property Interests Pursuant To a Decree of Divorce.

Pursuant to section 247-3(4), HRS, there is a tax exemption for any document or instrument transferring a real property interest for nominal consideration between a husband and a wife. In a divorce proceeding, transfers of real property interests may occur between spouses as a part of the division of the marital property of the parties. The Department recognizes that, depending on the circumstances of the parties as determined by the Family Court, the actual transfer of real property interests may take place at different times: prior to the dissolution of the marriage pursuant to a property settlement agreement; on a date simultaneous with the entering of the final decree of divorce; or at a later date.

The Department notes that a literal application of the statute would require all transfers of real property interests to occur prior to the entering of the final decree of divorce in order to qualify for the exemption. The Department, however, takes administrative notice of the authority of the Family Court to determine and set the appropriate time of transfer of all property rights between the parties, including real property interests, and, therefore, will allow the section 247-3(4), HRS, exemption to apply to transfers of real property interests between divorcing couples pursuant to a divorce proceeding without regard to the actual dates of transfer. The exemption shall be applicable only to transfers of real property interests between the marital parties to a divorce, and any transfer must be in accordance with and pursuant to an order of the Family Court.

12. Conveyance Where There Is Consideration of \$100 or less Paid or To Be Paid.

Pursuant to section 247-3(5), HRS, a conveyance of a real property interest for consideration of \$100 or less, essentially a gift, is exempt from the conveyance tax.

Thus, bona fide gifts, transfers made without consideration, and transfers made for less than \$100 are exempt from the conveyance tax.

The Department has found this to be an area of abuse and misinterpretation. Consequently, if a conveyance is not to close relatives, the Department may require the taxpayer to submit documentation and clarifying information supporting the exemption.

Examples of conveyances which may not be questioned include those "for natural love and affection and \$1", "with a desire to promote public welfare and \$1", or "for \$99". A transfer "for \$1 and good and valuable consideration" may not qualify for an exemption unless evidence sufficiently documenting the "good and valuable consideration" at a value of less than \$99 is submitted to the Department.

Other concerns with respect to the Conveyance Tax Law may come to the Department's attention as the Department continues its review of certificates for exemption, and the Department will issue additional tax information releases clarifying the administration of the Conveyance Tax Law.


RICHARD F. KAHLE, JR.
Director of Taxation