

## HARPTA USE OF HAWAII FORMS ON TAX WITHHOLDING

In order to promote a greater level of compliance by nonresidents of Hawaii (whether U.S. persons or foreigners) in reporting income from sales of real property located in Hawaii, Section 235-68, Hawaii Revised Statutes ("HRS"), requires every buyer of Hawaii real estate to deduct, withhold, and pay to the Hawaii Department of Taxation 7.25% of the amount realized by the seller or transferor of Hawaii real estate.

This 7.25% withholding tax is designed to enforce Hawaii state income taxes on the sale or disposition of Hawaii real estate in the same manner as the enforcement provisions of The Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"). Similar to FIRPTA enforcement provisions, the state tax withholding requirement would not increase the amount of income tax paid by nonresidents since the amount withheld will be claimed as a payment on the Hawaii nonresident income tax return.

### GENERAL RULE

Under the Hawaii withholding requirement, the buyer or transferee of any Hawaii real estate is required to (i) withhold and deduct a tax equal to 5% of the amount realized by the seller or transferor upon the disposition of the property and (ii) file Forms N-288 and N-288A to report and transmit the amount withheld to the Hawaii Department of Taxation within 20 days of escrow closing, unless one of four exemptions apply.

### EXEMPTIONS FROM WITHHOLDING

- 1. Transferor furnishes Hawaii Resident Certification.** No withholding is necessary if the seller or transferor furnishes to the transferee a properly completed Form N-289 stating (i) the transferor's federal taxpayer identification number (last 4 numbers of the social security number, individual identification number or federal I.D. number), (ii) address, and (iii) that the transferor is a Hawaii resident. However, this exemption will not apply if the transferee has **actual** knowledge that the information on the Form N-289 is false. (Note that the definition of Hawaii resident for purposes of the withholding required by HRS § 235-68 would include foreign corporations and partnerships which are registered with the Hawaii Department of Commerce and Consumer Affairs to do business in the State of Hawaii).
- 2. Transferor's Affidavit of Principal Residence.** No withholding is necessary if the transferee receives an affidavit by the transferor stating (i) the transferor's federal taxpayer identification number, (ii) that the transferor used the property as a principal residence for the year preceding the date of the transfer and (iii) the sales price for the property does **not exceed** \$300,000.
- 3. Transferee Receives Hawaii Withholding Certificate.**
  - (a) The withholding under HRS § 235-68 may be reduced or eliminated pursuant to a "withholding certificate" issued by the Hawaii Department of Taxation. A withholding certificate may be issued by the Hawaii Department of Taxation upon receipt of Form N-288B establishing that either (i) the transferor will not realize any gain with respect to the transfer or (ii) the transferor will have insufficient proceeds to pay the withholding required by HRS § 235-68 **after** payment of all costs, including selling expenses and the amount of any mortgages or liens secured by the property.
  - (b) The withholding may also be reduced or eliminated pursuant to a "written agreement" with the Hawaii Department of Taxation. Persons who engage in more than one real property transaction in a calendar year or to whom meeting the withholding requirements are not practicable are eligible to enter into these written agreements.
- 4. Notice of Non-recognition Treatment.** No withholding is necessary if transferee receives from transferor a properly completed Form N-289 stating (i) that transferor is not required to recognize gain or loss with respect to the transfer and (ii) briefly describing the transfer and summarizing the law and facts supporting transferor's claim. Non-Hawaii residents doing 1031 exchanges of real estate may consider this option to avoid withholding.

## FIRPTA

The Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA") provided that foreign investment in U.S. real estate would be subject to U.S. capital gains tax on dispositions of U.S. real property interests [defined as (i) any interest in U.S. real property or (ii) any interest in a U.S. corporation in which 50% of its assets constitute U.S. real property interests].

To administer and enforce FIRPTA, the U.S. Congress in 1984 enacted Section 1445 of the Internal Revenue Code ("Code"), which is a provision designed to ensure that foreigners file U.S. tax returns and pay U.S. taxes on the disposition of a U.S. real property interest.

### GENERAL RULE

Under the FIRPTA withholding provisions of Code Section 1445, the buyer or transferee of any U.S. real property is required to (i) withhold and deduct a tax equal to 15% of the amount realized by the seller or transferor upon the disposition of the property regardless of the amount of cash otherwise present in the transaction and (ii) file Forms 8288 and 8288-A to report and transmit the amount withheld to the Internal Revenue Service ("IRS"), unless one of five exemptions applies.

However, the transferee's compliance with the withholding requirement does not relieve the transferor from its FIRPTA tax liability. The withholding tax is designed only to approximate the transferor's tax on net gain and such transferor would still be required to file a federal income tax return with the IRS for the year in which the sale occurs and either (i) obtain a refund of any amount overwithheld or (ii) make additional payments required in excess of the amount of tax previously withheld.

### EXEMPTIONS FROM WITHHOLDING

- 1. Transferor furnishes Non-Foreign Status Certification.** No withholding is necessary if the seller or transferor furnishes to the transferee a certification stating, under penalty of perjury, that the transferor is not a foreign person and stating the transferor's U.S. taxpayer identification number and address. However, this exemption will not apply if (a) the transferee has actual knowledge that the certification is false, (b) the transferee receives a notice from the transferor's or the transferee's agent that such certification is false, or (c) regulations are adopted requiring that the transferee furnish a copy of such certification to the IRS and the transferee fails to comply. (The current Treasury Regulations have no such requirement.) The transferee must keep such certification for at least 5 years.
- 2. Purchase Price for Residence.** No withholding is necessary if the property is acquired by an individual transferee for use by him or her as a residence and the sales price for the property does not exceed \$300,000. For sales prices over \$300,000 up to & incl. \$1 million, 10% withholding is required.
  - (a) Property is acquired for use as a residence if on the date of the transfer the transferee has definite plans to reside at the property for at least 50% of the number of days that the property is used by any person during each of the first two 12-month periods following the date of transfer.
    - (i) Days vacant do not count.
    - (ii) Use by a member of transferee's family [defined as brothers, sisters, spouse, ancestors and lineal descendants] counts as use by transferee.
  - (b) Transferee will be held liable for failure to withhold if he or she does not in fact reside at the property, UNLESS he or she establishes that the failure to reside was caused by a change in circumstances which could not reasonably have been anticipated at the time of the transfer.
  - (c) Because of the possibility that the transferee may be held liable for failure to withhold if he or she does not in fact reside at the property, this exemption should not be relied upon unless absolutely necessary. It is always better to obtain the non-foreign status certification noted above.
- 3. Transferee Receives IRS Withholding Certificate.** The withholding under Code Section 1445 may be reduced or eliminated pursuant to a qualifying statement issued by the IRS (the regulations refer to the statutory term "qualifying statement" as "withholding certificate"). A withholding certificate may be issued by the IRS in cases where (i) the transferor is exempt from U.S. tax, (ii) an agreement for the payment of tax is entered into with the IRS, or (iii) reduced withholding is appropriate. The IRS will issue a withholding certificate that permits the transferee to withhold a reduced amount only upon a determination that the reduced withholding will not jeopardize the collection of tax. The IRS must act upon a completed application for a withholding certificate not later than the 90th day after its receipt, except in unusually complicated cases where the IRS must notify the applicant by the 45th day after receipt of the application that additional processing time will be necessary. Under certain circumstances (IRS Form 8288-B) may be used to apply for such IRS withholding certificate.
- 4. Notice of Non-recognition Treatment.** No withholding is necessary if transferee (a) receives the appropriate notice from transferor that transferor is not required to recognize gain or loss with respect to the transfer in compliance with the requirements of Treasury Regulations § 1.1445-2(d)(2) and (b) provides a copy of the notice to IRS within 20 days of the property transfer. **HAVE A TAX ATTORNEY FAMILIAR WITH TREASURY REGULATIONS § 1.1445-2(d)(2) REVIEW THE NOTICE TO ENSURE COMPLIANCE WITH REQUIREMENTS OF THE EXEMPTION BEFORE CLOSING.**
- 5. U.S. Corporation Not USRPI.** Sale of stock in a U.S. corporation may be exempt from withholding under certain circumstances. **CONSULT WITH YOUR ATTORNEY ON MATTERS RELATED TO THE SALE OF STOCK.**