LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

MARIE C. LADERTA
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

July 29, 2005

DEPARTMENT OF TAXATION ANNOUNCEMENT NO. 2005-02

RE: Act 23, Session Laws of Hawaii 2005, Relating to the Withholding of Tax on the Disposition of Real Property by Nonresident Persons (Act 23)

On April 22, 2005, the Governor signed S.B. No. 842, S.D.1, an administration sponsored measure, into law as Act 23, Session Laws of Hawaii 2005 (Act 23). Act 23 clarifies the State withholding tax provisions relating to the disposition of real property by a nonresident person.

This Act clarifies that where a limited liability company (LLC) is formed or registered to do business in Hawaii and consists of a single member, and the limited liability company has not elected to be taxed as a corporation, the limited liability company will not be included in the exemptions to the Hawaii Real Property Tax Act (HARPTA).

HARPTA is codified at Section 235-68, Hawaii Revised Statues (HRS), and requires the buyer of real property to withhold 5 percent[1] of the gross proceeds of the sale, if the seller does not provide sufficient evidence of exemption from HARPTA. Currently, an exemption is available if the seller is a resident in the State, but which might include an LLC formed under chapter 428, HRS or any foreign limited liability company registered to do business in Hawaii under chapter 428, HRS.

Both federal and State tax law disregard the existence of a single member LLC if it has not elected to be taxed as a corporation. In this situation, the filing and reporting obligations for tax purposes flow to the sole member. Act 23 clarifies that a loophole does not exist where a non-Hawaii owner selling property through a single-member LLC formed or registered to do business under chapter 428, HRS, and which has not elected to be taxed as a corporation is subject to the HARPTA requirements.

This Act clarifies that where the single member LLC has not elected to be taxed as a corporation, the HARPTA withholding provisions are to be applied without regards to the existence of the LLC, and instead the residency of the single-member would be considered to determine whether HARPTA applies to the transaction.

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[1] The 5 percent is not a tax but a withholding mechanism to ensure that the proper taxes are filed and paid by the seller upon the sale of the property. After filing the appropriate tax return, the seller would receive the withholding back, less any taxes due.

This Act took effect upon approval and applies to taxable years beginning after December 31, 2004. This bill gives rise to no inference of the proper tax treatment of single member LLC transactions which occurred prior to January 1, 2005.

Current forms and other tax information are available at the Department's website at: www.state.hi.us/tax. If you know which tax form or publication you need, please call the Department's request line at 808-587-7572, or toll-free from the neighbor islands and continental U.S. at 1-800-222-7572. This service is available 24 hours a day, 7 days a week.



KURT KAWAFUCHI
Director of Taxation

HRS Sections Explained: HRS section 235-68.