

## **Hawaii Real Property Tax Law (HARPTA)**

**NOTE:** This paper is based upon Hawaii Tax Information Release No. 2017-01. The questions and answers are designed to help nonresident (absentee) owners understand the Hawaii Real Property Tax (HARPTA) Law.

**NOTE:** Neither Stott Real Estate, Inc. nor any of our agents or employees is licensed to provide either legal or tax advice. Licensed professionals such as attorneys or CPAs should be consulted for legal or tax advice.

### **1. What is HARPTA?**

HARPTA is an acronym for the Hawaii Real Property Tax Law. HARPTA is a law, not a tax, a common misunderstanding. The Hawaii law is similar to laws passed by other states (e.g., California) as well as a federal law that applies to non-U.S. citizens. Under HARPTA, an estimate of an owner's capital gains tax that will be due Hawaii is withheld at closing. Prior to the passage of HARPTA, the state had no means of collecting such taxes unless the absentee owner filed a Hawaii income tax return for the year of the sale.

**NOTE:** Some absentee owners may be exempt from the HARPTA law. However, the fact that an owner may be exempt from the HARPTA law does not also exempt the owner from paying state capital gains taxes that may be due Hawaii.

### **2. How much is collected under the HARPTA law?**

The amount collected under the HARPTA law is **7.25% of the sales price.**

### **3. What is the actual Hawaii capital gains tax?**

The Hawaii capital gains tax on real estate is 7.25%. This applies to all four factors of gain; refer to #14 for a discussion of the four factors.

### **4. If the collected amount is too large, how do you obtain a refund?**

If the 7.25% of sales price withholding is too large, the owner files a Hawaii form N-288C after closing. If the appropriate Hawaii income tax return (ex: form N-15) for the year is available, then the owner should file the appropriate tax return instead of filing form N-288C. The state will reject form N-288C if form N-15 is available. Hawaii has no provision for filing a form prior to closing so the correct amount will be withheld.

**5. What if there are insufficient proceeds from the sale to pay the withholding or if there is a loss on the sale rather than a gain?**

The withholding may not be required if there are insufficient proceeds from the sale or if there has been a capital loss rather than a capital gain. **When either of these occurs, escrow will not close the transaction until a Hawaii form N-288B has been approved by the state (unless the seller agrees to pay the withholding).** If the sale creates a capital loss or the proceeds available are insufficient, the owner must submit appropriate paperwork to the state. This paperwork must include (as applicable): (a) a copy of the closing statement when the property was purchased; (b) documentation showing depreciation that has been claimed; (c) documentation for any capital improvements; (d) documentation for deferred gain from any prior sale(s) that adjusted the owner's buying basis; and (e), an estimated closing statement prepared by escrow.

**NOTE:** To allow time for approval, form N-288B must be submitted to the state at least ten business days prior to closing. Since an estimated closing statement prepared by escrow has to accompany form N-288B, it is usually submitted relatively late during the escrow process. If form N-288B is rejected by the state, there is usually insufficient time to submit a revised form and still meet the scheduled closing date.

**NOTE:** Most absentee owners should have a CPA or professional tax advisor prepare their N288B form to document a capital loss. It is relatively common for the state to reject applications because of insufficient documentation. We have had absentee owners agree to pay the withholding when there was no gain merely to be able to close their transactions as scheduled. The owners were reimbursed after the sale: however, they could have avoided any withholding had they submitted a better package.

**NOTE:** The state may adjust the withholding to a lesser amount if there is a gain but insufficient proceeds available to pay 7.25% of the sales price.

**NOTE:** Form N-288B has a section where the owner indicates if the property has been a rental and if so, the owner's Hawaii General Excise Tax (GET) number for the property. If you have not been paying Hawaii GET on your rental receipts, you may have to pay past GET plus a penalty/interest in order to have form N-288B be approved.

**6. Is Hawaii tax law for the sale of a personal residence similar to the federal law; i.e., the Taxpayer Relief Act of 1997?**

Yes. This federal law allows an owner to exclude up to \$250,000 of gain (single) or up to \$500,000 of gain (married) providing they have owned and occupied a property for at least two out of the past five years. Lower exclusions may be allowed under certain circumstances if the owner occupancy time frame has been less than two years.

**7. How does an owner obtain the HARPTA forms?**

The forms can for obtained from the state. Select "Forms" from Hawaii.gov/tax and go to the "Alphabetical List". Select "N" and scroll to the applicable form. The forms can be downloaded from the state website ([http://tax.hawaii.gov/forms/a1\\_b3\\_6harpta/](http://tax.hawaii.gov/forms/a1_b3_6harpta/)).

**8. What defines a nonresident?**

A nonresident owner for purposes of HARPTA is an owner who does not file a Hawaii resident tax return.

**9. Does HARPTA apply to military members?**

Military members are exempt from the withholding at closing if the sale involves their primary residence and they are being transferred from Hawaii under military orders and a N289 form has been completed. For purposes of HARPTA, a military member is defined as someone on active duty when their Hawaii property closes.

**10. Are there any exceptions to the 7.25% of sales price withholding?**

Following are the most common exceptions:

- a. The seller is a resident of Hawaii and form N-289 has been completed.
- b. The seller is currently a nonresident of Hawaii and has lived in the property as their primary residence for two of the past five years. The seller must fill out form N-288B and attach form N-103.
- c. There is no taxable gain on the sale and an approved form N-288B has been received from the state.

- d. There are insufficient proceeds from the sale to pay the withholding and an approved form N-288B has been received from the state. If some proceeds are available and there has been gain, the state may adjust the withholding to a lesser amount.
- e. In the year prior to the sale the property was used as a primary residence and the sales price is \$300,000 or less and the seller has completed an form N-289.
- f. The owner is in the military, being transferred from Hawaii under military orders, is selling their primary residence and has completed form N-289.
- g. The owner conducts an IRC 1031 tax-deferred exchange.

### **11. What do you mean by "no taxable gain?"**

No taxable gain applies when there is a loss on the sale rather than a gain. No taxable gain may also involve transfers of property incident to a divorce, as a gift, or as an inheritance.

### **12. What do you mean by an IRC 1031 tax-deferred exchange?**

Section 1031 of the Internal Revenue Code (IRC) provides for the deferment of capital gains taxes realized on the sale of investment real estate when it is exchanged for other investment real estate. Under IRC section 1031, if you sell investment real estate and buy more expensive investment real estate within a prescribed time frame, you can defer capital gains taxes on the property you are selling. Stott Real Estate, Inc. has a Special Report that discusses IRC section 1031 exchanges in considerable detail.

### **13. How is HARPTA enforced?**

HARPTA has the buyer responsible for paying the withholding if appropriate documentation is not provided by the seller. Therefore, escrow will automatically withhold 7.25% of the sales price unless the seller can document that no such withholding is required.

#### **14. Where can I obtain additional information?**

The law itself is short and basic; however, interpretations can be very complex, particularly for individuals who travel frequently making their residency questionable. The Income Tax Specialists at the Technical Section provide free assistance to the public. We have found them to be very cooperative and generous with their time.

They can be reached at:    Technical Section  
   P.O. Box 259  
   Honolulu, HI 96809

The toll-free number is:    1-800-222-3229 ext. 71577

The toll-free number is frequently busy. Some of our clients have found it easier to call long distance using the local number: (808)-587-1577.