

# Real Property Tax and Tax Aspects of Real Estate Ownership

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Chapter 24

# Real Estate Taxes

- Ownership of real estate is subject to taxation.
- Primary sources of government income:
  - Income tax
  - Sales tax
  - General excise tax
  - Real property tax

# Real Property Taxes

- ▶ Most common method of determining taxes is ad valorem (according to value).
- ▶ Responsibility for annual evaluation and assessment lies with each county.
- ▶ Property should be assessed at 100% of its fair market value.
- ▶ The tax rate is determined by each county and varies depending on the type & use of the property.

# Tax Collection

- Taxes are assessed on a calendar year.
- Are collected in two installments on a fiscal year which runs from July 1<sup>st</sup> to June 30<sup>th</sup>.
- The first installment due August 20<sup>th</sup> pays from July 1<sup>st</sup> to December 31<sup>st</sup>.
- The second installment due February 20<sup>th</sup> pays from January 1<sup>st</sup> to June 30<sup>th</sup>.

# More on Property Taxes

- ▶ Taxes become delinquent if they are not paid by each installment due date.
- ▶ After three years, a sale by public auction may be held.
- ▶ An owner may appeal the tax assessment.

# Assessments

- ▶ Special assessments for sidewalk or street widening, sewage or drainage systems, park or recreational facilities, or other general improvements may be levied by the county.
- ▶ Special assessment bills are sent out annually, and must be paid either in full or installments.
- ▶ Often times large assessments are prorated at closing and assumed by the buyer.

# Homeowner Tax Exemption

## Oahu

- \$80,000. under 65
- \$120,000. age 65 and up
- Special Exemption for homeowners age 75 years and older whose household qualifies as low-income.

- Homeowner Tax Exemption in the neighbor counties varies from county to county.
- Check with the Real Property Tax Division in the various counties for the current exemption.

# Home Exemptions

- ▶ Exemption amount is subtracted from the assessed value of the owner occupant and the homeowner is taxed on the balance.
- ▶ Homeowner must file for exemption by the deadline in each county.
- ▶ Exemption will remain in place until property is sold.



# More on Home Exemptions

- ▶ If a couple is separated and living in separate homes, they can prorate one home exemption.
- ▶ Home exemption is available to a person with a residential lease of five years or more who is responsible for paying taxes.
- ▶ Owners of co-op and condominiums qualify.
- ▶ Vendee in Agreement of Sale qualifies.

# Further Exemptions Apply to:

- ▶ Disabled veterans;
  - ▶ no tax at all.
- ▶ Blind
- ▶ Deaf
- ▶ Totally disabled
- ▶ Amputees
- ▶ Paralytics
- ▶ Incurably insane
- ▶ Hansen's disease
  - ▶ Leprosy
- ▶ Religious organizations
- ▶ Educational institution
- ▶ Government agency

# Depreciation Allowance

- A permissible deduction from income.
- Only for income producing properties and properties used in a trade or business.
- Not a principal residence.
- Difference between depreciation and other deductions; interest, taxes etc. is depreciation allowance need not be dollars spent in order to be claimed.

# Depreciation

- ▶ Minimum allowable depreciation time:
  - ▶ 27½ years for residential property.
  - ▶ 39 years for non residential property.
- ▶ Limitations under IRS passive loss rules.
- ▶ Land is not depreciable. Therefore there must be an allocation between land and improvements before depreciation can be taken.

# Tax Deferred Exchange (1031)

- ▶ Like kind properties which are held for productive use in a trade or business or investment.
- ▶ Does not apply to the exchange of personal residences or properties outside the U.S.
- ▶ IRS 1031 is tax deferred not tax free.

# More on IRS 1031 Exchanges

- Most common is a two party, delayed.
- The exchanger sells their property, and has a facilitator receive the funds.
- Exchanger has 45 days to identify new property (up to three) with a value up to 200% of value of the exchanged property.
- 180 days to close on new property.
- What is boot? Is it taxable?

# Rules on Personal Residences

- No depreciation allowance.
- No deduction for repairs or maintenance.
- Taxpayer relief act of 1997:
  - \$250,000 exclusion on the gain of residence.
  - \$500,000 if married filing a joint return.
  - Must have lived in house two of last five years.
  - Can do it repeatedly only every two years.

# Capital Gains Tax

- ▶ Maximum 20% rate, assets held more than one year; 10% for those in lower brackets.
- ▶ Maximum 18% rate, assets held more than five years; 8% for those in lower brackets.
- ▶ Short term gains of less than twelve months are taxed at regular income tax rates.
- ▶ These rates are subject to change.



# Imputed Interest

- ▶ When an owner offers financing at an unreasonably low interest rate; the IRS will impute a prescribed rate, computed semiannually.
- ▶ The seller must pay income taxes on the imputed interest.
- ▶ The buyer is able to deduct the imputed interest from his income taxes.

# Interest Deduction

- ▶ Mortgage interest on acquisition debt, up to one million dollars combined, to acquire, construct or improve a primary residence and second home is deductible.
- ▶ Home equity interest up to \$100,000 on a primary residence and second home is deductible.
- ▶ Refinancing issues.

# Federal Estate Tax

- ▶ The gross estate of a deceased person must be over \$1,000,000 before any federal estate tax is due.
- ▶ There is no limit on the amount left to a spouse.
- ▶ A federal estate tax return must be filed even if there is no tax due.

# HARPTA

- ▶ Not a separate tax, but a withholding requirement on absentee owners.
- ▶ Buyer must withhold 5% of sales price of non Hawaii resident sellers proceeds and forward to Hawaii tax within 20 days of closing.
- ▶ If buyer doesn't withhold, they may be liable for the tax.

# HARPTA Withholding Exceptions

- Seller is Hawaii resident
- Gain on sale is not recognized
  - IRS 1031 tax deferred exchange
  - \$250,000/\$500,000 principal residence
- Seller's principal residence in year preceding sale and sales price is not more than \$300,000.
- State tax issues withholding certificate.

# What is FIRPTA?

(IRS Publication 515)

- Withholding on non U.S. residents.
- Buyer is responsible to withhold 10% of sales price and send to IRS within 20 days of closing.
- If transferee doesn't withhold, they may be liable for the tax
- Real estate agent's liability, up to the amount of their commission.

# Exceptions to FIRPTA Withholding:

- Buyer will be owner occupant and sales price is not more than \$300,000.
- Seller gives certification to buyer stating that they are not a foreign person.
- IRS issues withholding certificate
- Buyer receives a notice of non-recognition of gain from seller
- Seller must still file annual tax return.

# Statutes that may be required of foreign buyers & sellers.

- ▶ Agricultural Foreign Investment and Disclosure Act of 1978
- ▶ International Investment and Trade in Services Survey
- ▶ Currency and Foreign Transactions Reporting Act of 1970
- ▶ Revised ordinances of City and County of Honolulu



# TAT and GET

- ▶ On rentals of less than 180 days, there is a Transient Accommodation Tax in addition to the GET.
- ▶ On all rental income there is a General Excise Tax.
- ▶ TAT and GET may be charged to the tenant.

# Condominium – Cooperative, Time Sharing, Planned Development Housing, and Subdivision

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# Condominium

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Hawaii Revised Statute 514A

Hawaii Revised Statute 514B

Hawaii Administrative Rules  
Title 16, Chapter 107

# Two Sets of Condo Law

As of July 1, 2006, there exist two sets of condominium laws.

- ▶ Chapter 514A, HRS (commonly referred to as the old law)
- ▶ Chapter 514B, HRS (commonly referred to as the new law)

# Condominium

- ▶ Hawaii was the first state to adopt a condominium law. (1961)
- ▶ A condominium is an interest in real property consisting of an individual and private interest in a particular unit (cubicle of air space), plus a proportionate interest in the land, plus an undivided interest in common in the common elements.

# Each Condominium Unit:

- ▶ Has an individual deed or lease.
- ▶ Is separately assessed for real property taxes.
- ▶ Can be individually mortgaged.
- ▶ Is eligible for homeowner exemption.
- ▶ Is eligible for title insurance as a separate piece of property.

# Condo Owner's Responsibilities

- ▶ Real property taxes
- ▶ Assessments
- ▶ Maintenance fee
- ▶ Lease rent if the property is not fee simple

# Advantages of Condominium over Cooperative

- ▶ Tax benefits in:
  - ▶ Mortgage interest deduction.
  - ▶ Real property tax deduction.
- ▶ Easier for an owner to sell.
- ▶ Less liability for other owners.



# Condominium Ownership is Popular in

- Resort areas
- Urban areas
- Office and professional buildings
- Medical clinics
- Recreational developments
- Condo-hotels
- Combined office and residential buildings

# Each Owner

- Has exclusive ownership of this unit
- Must comply with
  - Declaration
  - By laws
  - House rules
- Set up for the protection of all owners.

# The Developer

- ▶ Must execute and record a master deed (or lease) together with a condominium declaration.
- ▶ The declaration is the document by which one creates a condominium.
- ▶ Mechanics are set up at the bureau of conveyances and the land court for recordation of this and other instruments affecting individual apartments.

# The Declaration Contains:

- ▶ A detailed description of the land,
- ▶ Whether it is fee simple or leasehold,
- ▶ Number of stories,
- ▶ Number of apartment units,
- ▶ Location,
- ▶ Designated parking stalls,
- ▶ Floor area,
- ▶ Common elements,
- ▶ Limited common elements,
- ▶ Intended use of the building and units,
- ▶ Appurtenant common interest to each apartment.

# When Declaration is Recorded

- ▶ A true copy of the bylaws, together with a condominium map, floor plans, and elevations, must accompany the declaration.
- ▶ The declaration can be amended with written consent of
  - ▶ 75% of all owners, (old law)
  - ▶ 67% of all owners (new law)
- ▶ The developer needs to prepare a public report, which needs an effective date, before beginning any sales.

# After Initial Sales & Building

- Owners form AOA and select Board of Directors within 180 days.
- Board's purpose is to regulate, control, and maintain the common elements in the building
- Percentage of interest in common elements usually determines vote of each apartment owner.

# By-Laws

- ▶ Govern the property, the association's board is authorized to regulate and administer the affairs of the condominium. Especially in regard to maintenance and repair of the common elements.
- ▶ The association has the authority to assess and collect sufficient money to maintain the common areas.
- ▶ A lien may be placed against the apartment of delinquent owners.

# Must be Included in By-Laws:

- ▶ Number of board members,
- ▶ Election of board,
- ▶ Term of board,
- ▶ Powers & duties of board;
- ▶ Compensation, if any of board,
- ▶ Authority to hire managing agent,
- ▶ 65% Vote to amend by-laws. (old law)
- ▶ 67% Vote to amend by-laws. (new law)



# Board of Directors

- ▶ Owe the AOA a fiduciary duty,
- ▶ Prepare and adopt an annual operating budget,
- ▶ Includes estimated revenues and operation expenses, and total replacement reserves.
- ▶ Make available financial statements, minutes of the board, insurance policies etc.

# Record's Kept at Managing Agents Office

- Copy of declaration,
- Copy of by-laws,
- House rules,
- Master lease, if any,
- Sample original conveyance document,
- Public reports and amendments
- Copies made available to owners, prospective buyers and their agents.

# Disputes

- ▶ At the request of any party, any dispute concerning or involving one or more apartments and an association of owners, its board or managing agent, shall be submitted to arbitration.

# AOAO Must Purchase and Maintain Insurance

- ▶ That covers the common elements against loss or damage by fire and casualty.
- ▶ Commercial liability insurance of \$1,000,000 or more.
- ▶ Fidelity bond to cover board, managing agent.
- ▶ Flood insurance if property is located in a special flood hazard area.
- ▶ Each owner may insure their own apartments for their own benefit at their own expense.

# Documents Buyer Should Review in a Condo Resale

- Declaration,
- House rules,
- By-Laws,
- Public reports,
- Title report of recorded documents,
- Minutes of last three board meetings,
- Minutes of last annual AOO meeting,
- Current and proposed budget,
- Financial statements,
- Insurance summary,
- Reserves study,
- Articles of incorporation,
- Copies of any pending litigation,
- Property information form RR105(C)

# Areas of Potential Risk:

- Inadequate reserves,
- Deferred maintenance,
- Pending litigation,
- Inadequacy of insurance,
- Contentious board.

# Developer's Public Report

- ▶ Name and address of project & developer.
- ▶ Estimated maintenance fees.
- ▶ Description of all warranties.
- ▶ A summary of permitted uses of the units.
- ▶ Compliance with county building codes.
- ▶ Any other facts that would have a material impact on the use or value of a unit.

# Existing Structures

- ▶ A statement by an engineer or architect describing the condition of the structural components.
- ▶ A statement of the expected life of each item.
- ▶ A list of any outstanding code violations, together with the cost of curing them.
- ▶ Whether the property meets zoning codes.



Developers shall not enter into binding contracts with purchasers until:

- ▶ Purchasers have been given a copy of the public report,
- ▶ Purchasers are notified of right to cancel,
- ▶ Purchasers have had an opportunity to read them both;
- ▶ Purchasers have signed a receipt for them, waiving the right to cancel.

# If Purchaser Decides to Cancel

- ▶ Notify the seller by mail or telegram before:
  - ▶ The conveyance of the apartment;
  - ▶ Midnight by the 30<sup>th</sup> day after delivery of the public reports, whichever is earlier.
- ▶ The purchaser shall be deemed as waiving the right to cancel after 30 days.

# Voidable Sales

- ▶ Every sale that may include misleading statements or omissions is voidable at the election of purchaser,
- ▶ The person and anyone who participated in the sale, is jointly and severally liable to the purchaser for the full amount paid by the purchaser, with interest, together with court costs and attorney's fees.
- ▶ Misdemeanor; \$10,000 fine; 1 year jail;

# Sales to Owner Occupants

- ▶ Developer shall offer at least 50% of the units, constituting a proportionate representation, either chronologically or by lottery, for a thirty day period only to owner occupants.
- ▶ Buyers must sign a sworn owner-occupant statement to reside in the unit for at least 365 days and not lease or assign it to anyone else.

# Leasehold Condominiums

- ▶ When the land owner is offering to sell the land (fee conversion), he must give the AOA the right of first refusal to buy the fee interest.
- ▶ The AOA has 120 days to accept or reject the offer, provided that at least 75% of the lessees approve of the purchase.

# Condominium Conversion

- ▶ Transforming an apartment or office building into a condominium;
- ▶ Due to construction costs there is a trend towards conversion;
- ▶ The current tenants must be given:
  - ▶ Minimum of 120 days notice to convert.
  - ▶ Opportunity to purchase as an owner occupant.

# Numbers to Remember:

- ▶ 100% to enter into CPR.
- ▶ 80% to remove from CPR.
- ▶ 75% to amend the declaration (514A)
- ▶ 67% to amend the declaration (514B)
- ▶ 75% to change use of a common element. (514A)
- ▶ 67% to change use of a common element. (514B)
- ▶ 65% to amend the by-laws. (514A)
- ▶ 67% to amend the by-laws. (514B)

# Condominium Review:

- ▶ Students should consider a review of the entire set of rules governing condominiums including:
- ▶ Hawaii Revised Statutes 515A
- ▶ Hawaii Revised Statutes 515B
- ▶ Hawaii Administrative Rules, Title 16, Chapter 107



# Co-operative Apartments

Hawaii Co-op statutes enacted in 1992.

- ▶ Title is taken in the name of a corporation.
- ▶ Purchaser buys stock in the corporation.
- ▶ Purchaser gets proprietary lease.
- ▶ Sell with approval of directors.
- ▶ Maintenance fees may include:
  - ▶ Blanket mortgage, real property taxes, insurance, lease rent if applicable.

# Time Sharing

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Hawaii Revised Statute 514E

Hawaii Administrative Rules  
Title 16, Chapter 106

# Timesharing (HRS-514E)

- ▶ Timesharing is a concept that has blossomed in the United States within the last thirty years.
- ▶ Part of Hawaii Statutes since 1981.
- ▶ Purchaser buys the use or ownership of a resort accommodation for a certain period for a specified number of years, or forever.
- ▶ Pay for tomorrow's vacation at today's prices.
- ▶ Owner's can exchange some of their time for time in another timeshare resort, thus being able to enjoy vacations elsewhere.

# Two Categories

- Ownership Interest
  - Tenancy in common ownership
  - Interval ownership
- Right to Use
  - Vacation license
  - Vacation lease
  - Club membership

# Ownership Interest

- Buyer actually owns a fractional interest and gets title to it.
- Owner can:
  - Get title insurance.
  - Sell his interest.
  - Rent it out.
  - Take out a loan.
  - Deduct real property taxes & interest.

# Tenancy in Common

- Owner receives a deed to an undivided interest in the whole living unit based on the length of the time period he selects. The specific time period to be used is established by way of a separate agreement.

# Interval Ownership

- ▶ This ownership type does not require a separate agreement to establish the time use period, but is an 'estate for years' where the buyer actually owns and has title to the time period he has selected.
- ▶ He owns it every year for the pre-selected time period.

# Right to Use

- Right to use timeshares involve a lease agreement in which the buyer has the right to occupy the unit for a specified number of weeks for a certain term. (20 to 40 years)
- At the end of that period the ownership reverts to the developer.



# Vacation License

- ▶ A type of non-ownership timesharing often found where timeshares being sold involve an actual operating hotel.
- ▶ The buyer has the right to use a specific unit for a specified time period for the predetermined period of years.
- ▶ Buyer likely will not be able to sell at a profit, rent it out, or loan out the unit.

# Vacation Lease

- ▶ A non-ownership timeshare where the buyer buys a lease on a particular unit which offers him a fixed annual occupancy.
- ▶ He usually has a right to sub-lease or transfer his interest.

# Club Membership

- Buyer purchases a club membership, including the right to occupy a unit for a specified time period each year.
- The club purchases or leases a building at some resort area which is made available for use by club members.
- The unit of time may be fixed or may be selected annually.

# Responsibility for Time Share

- ▶ Under the authority of a time share administrator, appointed by the Director of the Department of Commerce and Consumer Affairs (DCCA);
- ▶ Registration of time share units is done with the time share developer filing a disclosure statement, and thus there is no Public Report required.

# Licensing of Agents

- No sales agent or acquisition agent shall act as a real estate salesperson without a license.
- Acquisition agent who is not licensed may solicit attendance to a time share presentation from a principal place of business, a branch office, site office or booth.

# Licensing of Agents (continued)

- ▶ An unlicensed acquisition agent may solicit from a booth as long as they stay in the booth.
- ▶ Unlicensed acquisition agents must be employed by a real estate broker.
- ▶ A real estate broker who employs an unlicensed acquisition agent is responsible for their acts.

# Buyer's Disclosure Statement

- Name and address of the developer and of the time share units.
- Name and address of plan manager.
- Description of time share units and completion schedule.
- Any restrictions on buyer's transfer of interest.
- Is it an ownership plan or use plan.

# Buyer's Disclosure Statement

- Notification of seven day rescission.
- Notice of liens, encumbrances and title defects.
- Any pending law suits?
- Total financial obligations of buyer.
- Estimate of dues, maintenance fees, taxes.
- Description of the condo project.
- Every sale in violation of HRS 514E is voidable at the election of the buyer.



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# Requirements Shall Not Apply to:

- ▶ Transactions pursuant to order of any court.
- ▶ Sale by governmental agency.
- ▶ Normal hotel operations.
- ▶ Any gratuitous transfer.
- ▶ Time share offered outside of Hawaii.

# Mutual Right to Cancel

- ▶ Sales agents need to inform all buyers of their mutual right to cancel.
- ▶ Within seven calendar days after the signing of the purchase contract, or seven days after the purchaser receives the disclosure statement, whichever occurs later, either party may cancel the contract without penalty.
- ▶ The seven-day rescission period must be contained in the sales contract above the signature line.

# Sales Made in Violation of HRS 515-E

- ▶ Are voidable at the election of the purchaser;
- ▶ The person making the sale and every other person who participated in the sale is jointly and severally liable to the purchaser for the full amount paid by the purchaser, together with interest at 10%, plus court costs, and attorney's fees less a pro rata share of any benefits the purchaser has actually received.

# Penalties for Violation of HRS 515E

- ▶ Fine of \$500 to \$25,000 per violation.
- ▶ Each date of violation shall constitute a separate offense.
- ▶ Suspension or revocation of registration of the person and the right to offer or sell time share interests.
- ▶ The director may order a cease and desist order.

# Review:

- ▶ Students should consider a review of the entire set of rules governing Time Sharing:
- ▶ Hawaii Revised Statutes 515E
- ▶ Hawaii Administrative Rules, Title 16, Chapter 106

# Planned Development Housing (P-DH) previously (PUD)

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# Planned Development Housing

- ▶ A type of housing and zoning being used more frequently as a means of utilizing the State's small amount of land efficiently as possible.
- ▶ Developer can place units closer together, reserving larger areas of open or recreational space.



# Developer of Land Submits Plans Showing

- ▶ The location and dimensions of the area,
- ▶ The existing and proposed buildings,
- ▶ Open areas,
- ▶ Topographic information,
- ▶ Surrounding lands uses.
- ▶ The development will then be evaluated as to the effect it may have on surrounding areas and a judgment rendered as to its desirability.

# PD-H Differs from a Condo

- In a PDH the unit is the lot, thus the owners own the land beneath their houses.
- There is no direct interest in the common areas.
- The community association is in corporate form.
- The PDH is created by covenants in the deed or master lease.
- The owners association is usually unincorporated.

# Subdivision

## Uniform, Land Sales Practices Act (ULSPA)

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Hawaii Revised Statute 484

Hawaii Administrative Rules  
Title 16, Chapter 104

# Subdividers Who Intend to Sell

- ▶ Must first comply with certain regulations of the county in which the property is located;
- ▶ Must post improvement completion bonds;
- ▶ Register the project with the DCCA

# Thrust of the Subdivision Law

- ▶ Protect the prospective purchasers from the deceptive practices and abuses that were once common in the sales of lots.
- ▶ There are numerous exemptions from registration.
- ▶ If the subdivision does not fall within one of the exemptions, proper steps must be taken to have the land registered.

# To Begin Registration

- ▶ The subdivider must submit an application to the director along with payment of registration fee and inspection fees.
- ▶ The director will take action on the application through investigation.

# The Investigation Will Determine If:

- ▶ Subdivider can convey the interests offered for disposition;
- ▶ Plans are not false or misleading;
- ▶ The subdivider has not been convicted of crimes involving land sales;
- ▶ Requirements of Public Offering Statement have been met;
- ▶ Purchaser has been notified of 7-day right to cancel;

# If Registration is Accepted:

- ▶ The subdivider may begin sales using the 'Public Offering Statement', which is designed to fully and accurately disclose all material and relevant facts concerning the subdivision.
- ▶ This must be given to the purchaser, allowing a reasonable opportunity to examine it.



# Purchaser's Right to Cancel

- ▶ Purchasers have a right to cancel the sales contract and receive a full refund within the seven-day period from the date of delivery of the Public Offering Statement.

# Penalties for Violations:

- ▶ Director may issue an order stopping all sales;
- ▶ Require the person to cease and desist from the unlawful practice;
- ▶ Violation is a felony;
- ▶ Fines from \$5,000 to \$250,000;
- ▶ Two year prison term;

# Review:

- ▶ Students should consider a review of the entire set of rules governing Subdivision:
- ▶ Hawaii Revised Statutes 484
- ▶ Hawaii Administrative Rules, Title 16, Chapter 104