



LEGAL NOTES

FROM THE DESK OF HAROLD CHU

During the holiday season (Thanksgiving, Christmas, Hanukkah, New Year, etc.), it is quite easy to get caught up in the hustle and bustle. During this holiday season, we encourage you to take some time to relax and enjoy what is really important to you. Spend time with those who are closest and most dear to you.

This time of the year also gives us the opportunity to pause and thank you for your support of our firm. It's been over 30 years since I came to the islands not knowing hardly any one. We could not have done this without you. We appreciate and thank you for your support, your kindness and for your business.

Our office will observe special hours because of Christmas and New Year. Our modified hours of operation are as follows:

- ▶ Friday, December 22, 2006
(closed all day)
- ▶ Monday, December 25, 2006
(closed all day)
- ▶ Friday, December 29, 2006
(closed all day)
- ▶ Monday, January 1, 2007
(closed all day)

In this issue, we discuss the increase in the general excise tax on Oahu. This increase shall become effective January 1, 2007. We also discuss the increase in the HARPTA withholding for non-resident sellers of real property. This also becomes effective January 1, 2007.

We wish you the happiest of holiday season, best wishes and good health both in the New Year and thereafter.

HAWAII SECONDHAND SMOKE LAW

By now, most of you know that Hawaii's Secondhand Smoke law went into effect on November 16, 2006. This law places a burden on employers and businesses which operate in an enclosed environment.

This law is an extension of Hawaii's anti-smoking statute that went into effect 17 years ago. The new statute addresses the dangers of secondhand smoke and is reflective of the growing trend nationwide. The law is applicable to employers and their places of business. There are certain exceptions that are set forth in the statute. A copy of the statute is available at our Website under "Links & Resources", "Selected Laws".

The new law prohibits smoking in enclosed or partially enclosed places of employment, and in seating areas of sports arenas, outdoor arenas, stadium and amphitheatres. Smoking is also prohibited within 20 feet of entrances, exits, windows that open, and ventilation intakes. Some of the broad exceptions in the statute are for private residences, hotel and motel rooms that are rented to guests and are designated as smoking rooms, retail tobacco stores, private and semiprivate rooms in nursing home, and correctional facilities.

Signs prohibiting smoking

must be clearly and conspicuously posted in and at the entrance to every place

open to the public and place of employment. Signs must be legible and include the words "Smoking Prohibited by Law" with letters of not less than one inch in height or the international "No Smoking" symbol consisting of a pictorial representation of a burning cigarette enclosed in a red circle with a red bar across it. Signs can be downloaded at www.hawaiismokefree.com.

Owners, operators, managers, and employers who fail to comply with this law shall be guilty of a violation and can be fined not more than \$100 for the first violation, not more than \$200 for a second violation within one year of the date of the first violation, and not more than \$500 for each additional violation within one year of the date of the preceding violation.

Smokers who violate this law and smoke in the non-smoking area are subject to a fine of not more than \$50.00 plus costs not to exceed \$25.00 for the issuance of a penal summons.



Increase in General Excise Tax

All of us on Oahu shall soon be paying more in general excise tax. On January 1, 2007, the general excise tax on Oahu shall increase by .5 % to 4.5 %. This tax is to be collected by all people doing business on the island of Oahu, neighbor island businesses who sell goods or services to customers on Oahu and by Oahu's landlords. The increase in the tax rate is to pay for Oahu's mass transit system.

When the general excise tax was 4%, businesses could charge 4.167% to pass on their general excise tax liability and county surcharge tax liability to the tenants or purchasers. Beginning January 1, 2007, businesses will be able to charge 4.712 %.

If you do business on more

than one island, you will need to separate your transactions by taxing districts. This is because not all counties are participating in this general excise tax rate increase. The general excise tax increase is only for Oahu. The amount can be properly reported in Part IV for any Oahu sales and Part V for general excise tax rate for the other counties.

For additional information about the county surcharge tax, you can visit the Department of Taxation's website at www.hawaii.gov/tax/surcharge or you can call the Call Center customer service at 587-4242. From the neighbor islands and continental U.S., you can call 1-800-222-3229.

Insurance Tip

Many of our clients own real property in their revocable living trusts.

Your trust should be named as an additional insured on your homeowner's policy and on any liability policy. You should be aware, however, that the appreciation in your real property is often not covered in the typical insurance policy. This is important because many homeowners have significant appreciation in their real property.



Some Suggested New Year's Resolutions Related to Real Property

1. Organize your important real estate documents so that you or someone else, in the event of your death, can find these documents. I know it is obvious, but you need to tell others where these documents are located.

2. If you recently acquired a new personal residence or you have a residence and have not done so, file a homeowner's exemption for that property. Depending on your age, the homeowner's exemption will reduce the tax assessed value of the property by at least \$40,000. The amount of the reduction will increase in increments of \$20,000 as you

reach each age plateau. This is significant tax savings each year and only involves a one time investment of minutes of your time.

3. If you are a landlord, get the contact information for the last two prior landlords from your prospective tenants and **call those references**. This effort may help minimize significant out of pocket losses and legal fees that are often associated with a bad tenant. Minimize potential problems!

4. Read documents pertaining to your real estate property **prior** to signing the documents. If you do not wish to read the

documents, hire someone to read them and explain the impact of the documents to you. It is usually more expensive to resolve the problem **after** the documents are signed.

5. Any and all agreements pertaining to real property, such as the sale of real property, the rental of real property, and any commissions owed, should be in writing and signed by all parties.

6. Do not let real estate related problems linger. It has been our observation over the past thirty years that delay generally makes the problems worse and more expensive for you.

JANUARY 1, 2007 INCREASE IN HARPTA WITHHOLDING

Under the Hawaii Real Property Tax Law (HARPTA), the State of Hawaii withholds from the sales proceeds for non-Hawaii residents an **estimate** of the seller's capital gains tax that may be due to the State of Hawaii. The withholding of the HARPTA amount is done at Closing. Prior to the passage of HARPTA, the State of Hawaii had no means of collecting such taxes unless the non-resident owner filed a Hawaii income tax return for the year of the sale. A non-resident for purposes of HARPTA is defined as an owner who does not file a Hawaii resident tax return.

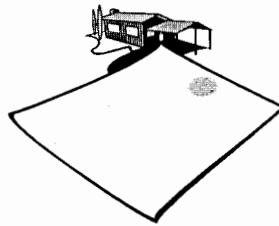
Presently, under HARPTA, there is a withholding of 5% of the sales price of the property. The recent State legislature increased the percentage to be withheld because a 5% withholding was insufficient for an absentee land owner that had sizeable gains and/or sizeable depreciation. Non-resident owners would have 5% of the sales price withheld, but would not file a state tax return for the year of sale and would not pay the difference owed to the State of Hawaii.

Military members are exempt from the HARPTA withholding if the sale involves the owner's primary residence and they are transferred from Hawaii due to military orders and a N-289 form has been completed. A person is deemed to be a military member if they are on active duty when their Hawaii real property closes.

Effective January 1, 2007, the amount of HARPTA to be withheld from sales for non-resident sellers of real property will be increased to 8.25% of the sales price. When you compare these two rates, this is a significant increase for non-resident sellers.

For example, a 5% HARPTA withholding on a \$400,000 sale is \$20,000. Using the same sales price of \$400,000, under the increased HARPTA withholding rate, the amount withheld would be \$34,000. This is \$14,000 more than what was previously withheld.

Under Hawaii tax law, the sale of a **personal** residence is treated the same as



under federal law. Like the federal law, for Hawaii state tax

purposes, an individual owner can exclude up to \$250,000 in gain. A married couple can exclude up to \$500,000 in gain. To qualify for such an exclusion, the real property owner must have owned **and** occupied the property for at least two years out of the last five years.

The current Hawaii tax rate on capital gains from the sale of real estate is 7.25%. In many cases, the increased HARPTA withholding will be greater than the capital gains taxes owed. The new HARPTA withholding rate is intended to encourage non-resident sellers to file for a refund.

You can get a refund if the HARPTA amount withheld is greater than the capital gains tax you actually owe. The non-resident seller should file Hawaii tax return form N-288C after Closing to calculate the actual tax owed and then apply for a refund, if applicable. Refunds are expected to take four to six weeks, except during tax season.

The HARPTA withholding may not be required if there are insufficient proceeds from the sales to pay the

HARPTA withholding or if there is a capital loss on the sale rather than a capital gain. In either event, however, the transaction will not close until a form N-288B has been approved by the State. To secure the approval of Form N-288B, the owner must present:

- a) a copy of the Closing Statement when the property was initially purchased;
- b) documentation showing depreciation that has been claimed;
- c) documentation for any capital improvements;
- d) documentation for any deferred gain from any prior sales that adjusted the owner's acquisition basis; and
- e) the estimated closing statements prepared by escrow.

In essence, this is the paperwork the State of Hawaii would require to calculate and determine the capital gain or the capital loss for your transaction. This could potentially delay the transaction. One alternative is for the seller to pay the HARPTA withholding and process the request for a refund later.

It takes approximately ten days for the State to process a Form N-288B. Thus, if you anticipate a capital loss, this form should be done well in advance of the Closing date. It is recommended that non-resident owners have a CPA or a professional tax advisor assist with completing form N-288B.

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Humor

After being away on business for a week before Christmas, Tom thought it would be nice to bring his wife a little gift.

"How about some perfume?" he asked the cosmetics clerk. She showed him a bottle costing \$50.

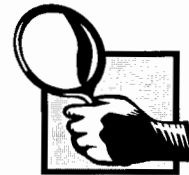
"That's a bit much," said Tom, so she returned with a smaller bottle for \$30.

"That's still quite a bit," Tom grouched.

Growing disgusted, the clerk brought out a tiny \$15 bottle.

Tom grew agitated, "What I mean," he said, "is I'd like to see something real cheap."

So the clerk handed him a mirror.



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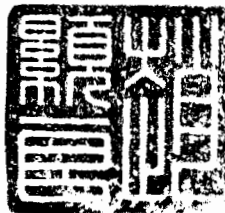
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Happy Holidays

Thank you for loyalty and goodwill!

We wish you peace, joy, hope and happiness this holiday season and throughout the coming year.

Harold



Cora

Jan



Happy New Year!