

Political Offices: U.S. House of Representatives: Committees: Ways and Means: Ways and Means: Tax deductibility of real property on leasehold

Thomas P. Gill Papers

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88TH CONGRESS
1ST SESSION

H. R. 8363

IN THE SENATE OF THE UNITED STATES

DECEMBER 3 (legislative day, NOVEMBER 29), 1963

Referred to the Committee on Finance and ordered to be printed

AMENDMENT

Intended to be proposed by Mr. FONG to the bill (H.R. 8363) to amend the Internal Revenue Code of 1954 to reduce individual and corporate income taxes, to make certain structural changes with respect to the income tax, and for other purposes, viz: At the proper place in title II of the bill insert the following new section:

1 SEC. . DEDUCTION BY LESSEE OF RESIDENTIAL LAND
2 OF CERTAIN REAL PROPERTY TAXES PAID
3 BY HIM.

4 (a) TAXES CONSIDERED AS IMPOSED ON LESSEE.—

5 Section 164 (relating to deductions for taxes) is amended
6 by redesignating subsection (g) as (h), and by inserting
7 after subsection (f) the following new subsection:

Amdt. No. 338

1 “(g) CERTAIN REAL PROPERTY TAXES PAID BY
2 LESSEE OF RESIDENTIAL LAND.—

3 “(1) TAXES CONSIDERED AS IMPOSED ON LES-
4 SEE.—For purposes of subsection (a), real property
5 taxes paid or accrued with respect to land by a lessee of
6 such land shall be treated as real property taxes imposed
7 on such lessee (and not on the owner of such land) if—

8 “(A) a residence owned by the lessee is
9 situated on such land,

10 “(B) the lessee is required under the lease to
11 pay all real property taxes assessed with respect
12 to such land, and

13 “(C) the term of the lease is for a period of
14 20 years or more.

15 “(2) LEASE CONSIDERED AS SALE.—For purposes
16 of subsection (d), the entering into of a lease of land
17 described in paragraph (1) by a lessee described in
18 such paragraph shall be treated as a sale of the land, and
19 the lessor and lessee shall be treated as the seller and
20 purchaser, respectively.

21 “(3) APPLICATION TO SUBLESSEES.—For pur-
22 poses of paragraphs (1) and (2) (other than para-
23 graph (1) (C)), the terms ‘lease’, ‘lessor’, and ‘lessee’
24 include a sublease, sublessor, and sublessee. The re-
25 quirement of paragraph (1) (C) shall be treated as

1 being satisfied with respect to a sublease if the term
2 of the lease is for a period of 20 years or more.”

3 (b) EFFECTIVE DATE.—The amendment made by sub-
4 section (a) shall apply to taxable years beginning after the
5 date of the enactment of this Act.

Amdt. No. 338

88TH CONGRESS
1ST SESSION

H. R. 8363

AMENDMENT

Intended to be proposed by Mr. FONG to the bill (H.R. 8363) to amend the Internal Revenue Code of 1954 to reduce individual and corporate income taxes, to make certain structural changes with respect to the income tax, and for other purposes.

DECEMBER 3 (legislative day, NOVEMBER 29), 1963
Referred to the Committee on Finance and ordered
to be printed

T.

This amendment was rejected by
the Senate Finance Committee on
Wednesday, December 18.

P
12/23

APPROX 104
12/23/23 ✓ full

Tax treatment of gain from a sale of
leased land pursuant to the exercise
by a lessee of a statutory option

Attached hereto is a draft of proposed Federal legislation to afford income tax protection to landowners in Hawaii in the event of the future enactment in Hawaii of legislation similar to the so-called Maryland Land Law which was considered at the 1963 session. A copy of the last form of the so-called Maryland Land Law considered (but not passed) by the Hawaii Legislature in 1963 is also attached hereto.

The general scheme of the draft is to treat a sale of leased land pursuant to the exercise by a lessee of a statutory option as the equivalent of an involuntary conversion of property used in the trade or business and not as a sale of property held primarily for sale to customers in the ordinary course of trade or business.

Section 1 would amend section 1231(a) and section 2 would amend section 1231(b) of the 1954 Code. Section 1231 of the 1954 Code contains the provisions which give capital gain treatment to gains from sales or exchanges of property used in the trade or business. Section 2 would add a new paragraph (5) to section 1231(b).

The basic operative provisions of the new paragraph (5) are in subparagraph (A). Subparagraph (A) provides that under specified circumstances the gain realized by a lessor by reason of the

exercise of a statutory option shall be treated as a gain on the sale of property used in the trade or business of the lessor and not as a sale of property held primarily for sale to customers in the ordinary course of trade or business. One of the specified circumstances is that there be a designated holding period. The duration of the holding period is left blank in the draft. It is suggested that a 10-year holding period would be appropriate.

Subparagraph (B) of the new paragraph (5) contains definitions. The definition of "lessor" is broad enough to include the fee simple owner of land as to which a statutory option is exercised and also to include any sublessor or other person entitled to share in rents or subrents of such land. The purpose of such a definition is to give any such sublessor or other person (as well as the fee simple owner) capital gain treatment of any payment which might be made to such sublessor or other person by reason of the exercise of the statutory option. However, the holding period is the holding period of the fee simple owner, without regard to the period of the interest of such sublessor or other person.

One of the most difficult problems relates to tacking, for the purpose of determining the holding period. Subparagraph (C) of the new paragraph (5) provides that tacking shall be determined under the rules of section 1223 of the 1954 Code. Section 1223

sets forth the general provisions for tacking and the determination of the holding period of property. Subparagraph (C) also provides that, if land shall have been acquired by a fee simple owner from a decedent or from a donor, the period of holding by the decedent or the donor and any period of holding by a trust estate created by the decedent or by the donor shall be included for the purpose of determining the holding period of the fee simple owner.

Subparagraph (D) of the new paragraph (5) contains a provision to the effect that the new paragraph (5) shall not apply with respect to any transaction covered by section 1055 of the 1954 Code. Section 1055 was incorporated into the 1954 Code by the enactment of the so-called Friedel Bill on April 10, 1963. Section 1055 is applicable to so-called ground rents in Maryland, under certain specified circumstances, one of which is that the right of purchase by a leaseholder must be by the payment of a determined or determinable amount, and another of which is that the lessor's interest must be primarily a security interest. It is recognized that section 1055 would not be applicable under the so-called Maryland Land Law as considered by the Hawaii Legislature. Subparagraph (D) may not be necessary, because the scopes of section 1055 and of the new paragraph (5) are mutually exclusive. However, although section 1055 and the new paragraph (5) do not cover the same subject matter, they do cover related subject matters, and it therefore seems desirable to include subparagraph (D)

in order to make it clear that the new paragraph (5) is not intended to impinge upon the scope of section 1055.

It has been suggested by some that a sale pursuant to the lessee's exercise of the statutory option should also be treated as an involuntary conversion for the purposes of Section 1033 of the 1954 Code, especially since Section 14 of the proposed Hawaii statute expressly so classified such a sale for Hawaii net income tax purposes. If this further effect is desired, there could be added to the attached draft of proposed Federal legislation an additional section reading as follows:

Section ____ . Section 1033(a) of the Internal Revenue Code of 1954 is amended by changing the parenthetical clause in the first sentence thereof to read as follows: "(as a result of its destruction in whole or in part, theft, seizure, requisition or condemnation or threat or imminence thereof, or a sale of land to a lessee under the circumstances specified in section 1231(b)(5))".

It will be noted that the draft does not deal with the problems, if any, that might arise for a lessor which is a charitable trust or other tax-exempt organization.

AN ACT

Relating to the tax treatment of the proceeds of the sale of land to a lessee under State or local law.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress Assembled,

Section 1. Section 1231(a) of the Internal Revenue Code of 1954 is amended by changing the parenthetical clause in the first sentence thereof to read as follows: "(as a result of destruction in whole or in part, theft, seizure, an exercise of the power of requisition or condemnation or the threat or imminence thereof, or a sale of land to a lessee under the circumstances specified in subsection (b)(5))".

Section 2. Section 1231(b) of the Internal Revenue Code is amended by adding a new paragraph at the end thereof, to be designated as paragraph (5) and to read as follows:

"(5) Sale Of Land To Lessee Pursuant To State Law.

"(A) The sale to a lessee of the entire interest in land of a lessor shall be considered to be an involuntary conversion of property used in the trade or business or a capital asset of the lessor and shall not be considered to be a sale of property held by the lessor primarily for sale to customers in the ordinary course of his trade or business, irrespective of the number of

such sales in any taxable year, if:

"(i) the lessee has a right to terminate such lease and to acquire the entire interest of the lessor in the land, which right exists by virtue of State or local law and not because of any private agreement or privately created condition, and

"(ii) such lessee exercises his right to purchase such entire interest, and

"(iii) the fee simple owner has held the land for a period in excess of _____ years prior to the date of purchase by the lessee.

"(B) As used in subparagraph (A): the term 'lessor' means and includes any fee simple owner, any sublessor and any person entitled to share in the rents or subrents of the land involved in an involuntary conversion described in subparagraph (A); and the term 'lessee' means and includes the original lessee and any successor who has the right under State or local law to bring about such involuntary conversion.

"(C) The period for which a fee simple owner has held land, within the meaning of clause (iii) of subparagraph (A), shall be determined under the rules of section 1223, except that if said land shall have been acquired by the fee simple owner from a decedent, within the meaning of section 1014, or if said land shall have been acquired by the fee simple owner from a donor,

within the meaning of section 1015 (other than section 1015 (c)), the holding period shall include the period during which said land shall have been held by such decedent or by such donor and also the period if any for which said land shall have been held by an inter vivos or testamentary trust estate created by such decedent or by such donor.

"(D) This paragraph (5) shall not apply with respect to any transaction governed by section 1055."

Section 3. This Act shall take effect upon its approval.

(To be made one and eight copies)

SECOND LEGISLATURE, 196 3
STATE OF HAWAII

H. B. NO.

24
H. D. 3
S. D. 1

A BILL FOR AN ACT

RELATING TO LEASES OF RESIDENTIAL REAL PROPERTY AND THE
PURCHASE OF FEE SIMPLE TITLE THERETO BY THE LESSEE.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 Section 1. Findings and declaration of necessity. The legislature
2 finds that: (1) a limited number of landowners own more than
3 three-quarters of the privately-held land in the State; (2) much
4 of this land is in rapidly developing urban areas; (3) such a con-
5 centration of ownership of private land results in a practical land
6 monopoly, and causes upward pressures on land prices; (4) such pres-
7 sures are made more intensive by the development practices of these
8 large landowners of making land available in rapidly developing
9 areas only as leaseholds and not in fee simple; (5) the ability of
10 a large number of people to acquire fee simple ownership of resi-
11 dential lots at a fair and reasonable price is an important factor
12 which vitally affects the development of the community; (6) the
13 number of residential leaseholds and the proportion these lease-
14 holds constitute of the total number of residential lots have
15 increased at a very rapid rate during the past fifteen years so
16 that today approximately fifteen per cent of all owner-occupied
17 units in the State are on leaseholds and approximately twenty
18 per cent on the most urbanized of the islands; and by 1980 it is
19 likely that more homes will be located on leased than fee simple

1 land; (7) it is also likely that more than eighty per cent of the
2 new residential lots which will become available for owner-occupancy
3 between now and 1980, especially in the most urbanized areas, will
4 be leaseholds unless significant changes are effected; (8) such a
5 limited availability of fee simple land for residential purposes
6 effectively deprives the people of Hawaii who desire to purchase
7 new or relatively new residences of the right to choose whether
8 they wish to own the land or lease the land on which their homes
9 are situated and makes such people live dependently upon the land
10 of others.

11 It is hereby declared as a matter of legislative determination
12 that the scarcity of fee simple houselots within the State of
13 Hawaii and, in particular, in the urban areas, is a matter affected
14 with the public interest and that measures to provide for the right
15 of individuals to purchase the fee simple title to houselots are
16 necessary in furtherance of the general welfare.

17 SECTION 2. Definitions. Unless a difference meaning clearly
18 appears from the use of the following terms as used in this Act,
19 they shall have the following meanings:

20 (a) The term "lease" includes subleases.

21 (b) The term "lessee" includes all persons named in
22 the instrument of lease or sublease as lessees or sublessees
23 and includes any assignees of such persons.
24
25

1 (c) The term "lessor" includes all persons named in the
2 instrument of lease or sublease as lessors or sublessors. It
3 includes the owners of the fee simple title and all other persons
4 ✓ who have an interest of record in the land, including, where
5 appropriate, developers.

6 (d) The term "lease", "lessor" and "lessee", or any pronoun
7 used in place thereof, shall mean and include the masculine or
8 feminine, the singular or plural and jointly and severally,
9 individuals or corporations, and their or each of their respective
10 heirs, successors, legal representatives and assignors, as may
11 be found appropriate to the context of this Act.

12 (e) The term "houselot" means a lot not exceeding one
13 acre in size and devoted to, or used for, or intended for, or
14 permitted for use as single family residential lot.

15 (f) The term "fair market value" means the amount of
16 money that a purchaser willing, but not obliged to buy the
17 property, would pay to an owner willing, but not obliged to
18 sell it, taking into consideration all uses to which the land
19 is adapted or might in reason be applied.

20 (g) The term "residence" shall mean and include residence
21 upon the houselot by the lessee or the ancestors, descendants
22 and an undivorced spouse of a lessee so long as the occupancy
23 for such residence has been under the same lease.
24
25

1 SECTION 3. Option to purchase. Any houselot which is hereafter
2 leased for a term (including any periods for which the lease may
3 be extended or renewed at the option of the lessee) in excess
4 of fifteen years, shall be purchasable in fee simple by the lessee,
5 at his option, in the manner hereinafter provided, at any time
6 after the expiration of five years from the date of the lease or
7 assignment of lease up to the date of expiration thereof, provided
8 that the lessee has occupied the premises as his personal residence
9 for at least five years next preceding the exercise of the option,
10 and is not then in default under his lease.

11 SECTION 4. Exclusions. The provisions of this Act shall not
12 apply to:

X 13 (a) any houselot which was leased and occupied as a resi-
14 dence prior to the effective date of this Act, and to any sublease,
15 assignment, extension or renewal of lease of such houselot.

16 (b) Hawaiian Homes lands within the provisions of Article
17 XI of the Constitution of the State of Hawaii, as amended.

18 SECTION 5. Effect of purchase. The effect of a purchase under
19 this act shall be to vest in the lessee all the right, title and interest
20 of the lessor in and to the houselot, subject however, to all covenants,
21 conditions, easements, reservations and restrictions of record running
22 with the land or those contained in the lease which are not inconsistent
23 with the intent of this act, and shall terminate all the right,
24 title and interest of the lessor, whether such interest be a remainder,
25 vested or contingent, a reversion or other beneficial interest in the

1 property, present or prospective, legal or equitable, provided such
2 lessor be given notice and compensated for his respective interest
3 as herein provided.

4 If the leasehold is subject to any mortgage, lien or encumbrance
5 suffered or permitted by the lessee herein, including but not limited
6 to rights arising through marriage, divorce or assignment, the same
7 shall continue in full force and effect and bind the fee acquired
8 by the lessee in the same order and priority as the same applied
9 to and bound the lessee's immediate previous leasehold interest.

10 SECTION 6. Exercise of option. A lessee desiring to exercise
11 his option to purchase after his lease becomes redeemable as herein
12 provided, shall exercise the same by sending written notice of his
13 intent to exercise said option by registered or certified mail to the
14 lessor and to all other parties in interest of record and those
15 personally known to the lessee. The notice shall identify the
16 date and recording data of the lease, a short description identifying
17 the houselot and the amount of the purchase price offered by the
18 lessee. Where any party in interest is not known to the lessee
19 either as to identity or the nature of his interest or claim, or
20 although known, cannot be found, or constitutes a class of persons
21 too numerous to notify individually, notice to such parties shall
22 be given by publication thereof at least three times in a news-
23 paper of general circulation in the city or county in which said
24 houselot is located.
25

1 Upon mutual agreement of the price and other terms of purchase
2 and upon payment of said price by the lessee, the lessor shall execute
3 and deliver to the lessee a good and sufficient deed, prepared at the
4 expense of the lessee, conveying and vesting in the lessee the fee
5 simple title to the houselot thereby purchased, and the lease there-
6 tofore existing between the parties shall be fully redeemed and
7 terminated. All payments under the lease, including rents, shall
8 continue to be paid by the lessee after delivery of said notice to
9 the lessor up to the time of full payment of purchase price, and any
10 proratable costs or charges arising out of said purchase shall be
11 prorated between the parties as of said date.

12 SECTION 7. Purchase price. The purchase price of the fee
13 interest subject to purchase by the lessee is the fair market value,
14 as herein provided, of such interest determined as of the date of
15 notice to exercise option, undiminished by the value of any interests
16 of sublessors, developers, mortgagees or lienors of the fee interest
17 or of the landowner. Such price as so determined shall be allocated
18 between and paid to the land owner, sublessors, developers, mortgagees
19 or lienors or other claimants as their respective interests may appear.
20 The purchase price may be determined by either mutual agreement,
21 arbitration or court proceeding as set forth herein, but shall not
22 be less than the fair market value of the houselot as determined by
23 the Department of Taxation for real property tax purposes as of the
24 date of execution, renewal or extension of the lease sought to be
25 redeemed.

1 In the determination of the fair market value, there shall
2 first be made an estimate of the fair market value of the land as
3 a fee simple houselot exclusive of any landscaping, walks, drives,
4 walls, fences, buildings and betterments placed upon the land or
5 paid for by a lessee. Such estimates shall be made without
6 reference to the lease or to the rental derived therefrom. From
7 this value there shall be deducted the cost of any other onsite
8 and offsite improvements (other than landscaping, walks, drives,
9 etc.) which have been previously paid for by a lessee. The cost of
10 such onsite and offsite improvements included in the original pur-
11 chase price of the leasehold estate shall be certified to by the
12 developer of the property at the time of the execution of the lease.

13 SECTION 8. Developer's interest. The interest in the purchase
14 price of a developer, sublessor, or other person entitled to share
15 in the lease rentals may be determined by agreement of those en-
16 titled to share in such purchase price. In the absence of such
17 agreement, the interest of a developer, sublessor, or other person
18 entitled to share in the lease rentals shall equal such person's
19 total share in the lease rentals for the remainder of the period
20 during which such person would be entitled to share in the lease
21 rental, discounted to present day value at five per cent per annum.

22 SECTION 9. Arbitration. If the parties cannot agree as to the
23 purchase price within thirty days from the receipt by the lessor of
24 the notice to exercise option, the parties may proceed to determine
25 the same by arbitration, subject to the provisions of Chapter 188,
Revised Laws of Hawaii 1955.

1 SECTION 10. Payment of purchase price. Upon the determination
2 of the purchase price, the lessee shall, within 5 days of such
3 determination, pay to the lessor an earnest money deposit equal to
4 five per cent of said purchase price. After payment of such deposit,
5 the lessee shall be permitted up to ninety days in which to pay the
6 balance of said purchase price. Thereafter, any failure by the lessee
7 to complete the purchase by full payment of the balance due shall,
8 unless extended by the lessor or by the court for good cause, con-
9 stitute a breach of the lessee's agreement to purchase and the lessor
10 shall be entitled to retain the deposited sum as liquidated damages.
11 Until payment in full is made by the lessee, the title shall not
12 pass, rental payments shall not abate and the lease will be deemed
13 to be in full force and effect provided, however, that nothing set
14 forth herein shall preclude the parties from mutually agreeing to
15 any other terms regarding the method of payment, including, but not
16 limited to, the deferral of payments by or through means of purchase
17 money mortgages, agreements of sale, or other forms of secured
18 transactions.

19 SECTION 11. Determination by Court. In the event that:

20 (1) The lessor and lessee cannot agree as to the purchase
21 price and do not submit the same for determination by arbitration
22 within forty-five days from the date of receipt of the notice
23 to exercise option, or

24 (2) The lessor fails or refuses to execute and deliver a
25 deed of conveyance within fifteen days after agreement is reached
as to all terms of the purchase and a tender of full purchase

1 price and demand for conveyance is made by the lessee, or fails
2 or refuses to execute the instruments necessary to effect the
3 purchase agreement, or

4 (3) The lessor is a trustee without power of sale under
5 a will, deed or other instrument for any trust, use or purpose,
6 or is a life tenant with a remainder over, vested or contingent,
7 or is the holder of a defeasible estate, but without power of
8 sale in such trustee, life tenant or holder of a defeasible
9 estate, or is an infant, ward, or incompetent, or any other
10 circumstances occur or exist as to the legal status of the
11 lessor or state of title of the houselot under option, or a
12 dispute exists between lessors regarding the proper allocation
13 of the purchase price, which prolong, preclude or prevent a
14 voluntary conveyance by the lessor of the subject houselot,
15 then the lessor, lessee, or any party in interest hereinabove con-
16 templated may petition the circuit court in the judicial circuit
17 where the houselot is situated for an order of conveyance, for
18 determination of fair market value, for specific performance, or
19 for any other relief as the circumstances require. Every petition
20 shall set forth the date and recording data of the lease, the
21 owner of the houselot and all documents, claims, liens, and
22 interests of record, the location and description of the houselot,
23 the notice and date of exercise of the option to purchase and such
24 other facts and circumstances as may be necessary to properly
25 present the matter to court for the relief sought. A copy of the

1 petition and summons shall be served upon the lessor and all parties
2 in interest of record or personally known to the lessee, either by
3 personal service or by publication, as the case may be, as provided
4 by law for civil cases generally, and as set forth in the Hawaii
5 Rules of Civil Procedure.

6 The Court shall have power to hear and determine all adverse
7 or conflicting claims to the houselot sought to be purchased and to
8 the compensation or price to be paid to the lessor and other parties
9 in interest for conveying and releasing their respective interests
10 in the same.

11 SECTION 12. Abandonment of suit. Whenever any proceedings
12 instituted under the provisions of this Act are abandoned or dis-
13 continued by lessee before final judgment, or if for any cause the
14 lessee fails to complete the purchase upon the terms determined by
15 the court, the lessor shall be entitled in such proceedings to
16 recover from the lessee all such damage as may have been sustained
17 by lessor by reason of the bringing of the proceedings by the lessee,
18 including costs of court, reasonable attorney's fees and other reason-
19 able expenses incurred in connection therewith. Issues of fact
20 arising in connection with any claim for such damage shall be tried
21 by the court without a jury within ten days from the date of the
22 entry of an order or judgment allowing the discontinuance of the
23 proceedings or dismissing the proceedings or denying the right of
24 the lessee to the option. The court may at any stage in the pro-
25 ceedings require the lessee to deposit with the court, as evidence

1 of good faith a sum not to exceed \$500.00 which such sum may be
2 applied to the purchase price, or in the event the lessee fails
3 to complete the purchase, may be applied to the damages as set
4 forth above.

5 SECTION 13. No estoppel or waiver. No lessee qualified to
6 effect the purchase of the fee, shall be estopped by any covenant,
7 term, condition or contract, however worded, from claiming the
8 right granted to him by this Act or otherwise be deemed to have
9 waived such right. Any attempted circumvention of this law with
10 the intent to nullify the provisions hereof shall be null and void
11 and the lessee shall retain all the rights herein provided.

12 SECTION 14. Involuntary conversion. Notwithstanding the
13 repeated execution by a lessor of leases, or renewal or extension
14 of leases of houselots with knowledge that the same may become
15 subject to the provisions of this Act, such lessor shall not be
16 deemed to be a "dealer" in the sale of real property or one holding
17 real property primarily for sale to purchasers in the ordinary
18 course of trade or business; and further, any conveyance of title
19 by a lessor upon the exercise by the lessor upon the exercise by
20 the lessee of the purchase option as herein provided, shall con-
21 stitute and be deemed an involuntary conversion of the lessor's
22 interest in the property so conveyed for the purpose of applicable
23 provisions of the Internal Revenue Code and Chapter 121, Revised
24 Laws of Hawaii 1955, as amended as well as any and all other statutes,
25 rules, regulations, administrative orders and legal interpretations/

1 within the Federal and State governments relating to taxation.

2 SECTION 15. Authority for trustees and executors to lease
3 pursuant to this Act. Notwithstanding any limitations in any
4 instrument creating any estate or trust, and regardless of whether
5 such estate or trust was in effect prior to the effective date of
6 this Act, which forbids or restrains the sale of real property of
7 such estate or trust, or which gives to any trustee or trustees a
8 discretionary power of sale, or which restricts or denies the
9 powers of trustees, executors, or officers of such estate or trust
10 to grant leases containing an option to purchase, the trustee,
11 executors or officers of such estate or trust may enter into leases
12 in excess of 15 years and shall convey the property subject to such
13 lease upon the exercise of the option by the lessee as provided
14 herein. Every will or trust instrument now in existence or herein-
15 after executed shall be construed in conformity with the intent
16 and purpose of this Act.

17 SECTION 16. State land. Any law to the contrary notwith-
18 standing, the provisions of this Act shall apply to leases of
19 public land in the same manner as to private land.

20 SECTION 17. Assignments. All leases subject to the provisions
21 of this Act shall be assignable by the lessee without approval or
22 consent of the lessor, provided, however that no such assignment
23 shall be effective to transfer any interest in the lease unless
24 the lessor is given a true executed copy of such assignment or
25 written notice thereof.

1 SECTION 18. Severability. If any section, sentence, clause
2 or phrase of this Act, or its application to any person or other
3 circumstance, is for any reason held to be unconstitutional or
4 invalid, the remaining sections, sentences, clauses and phrases of
5 this Act, or the application of this Act to other persons or cir-
6 cumstances, shall not be affected. The legislature hereby declares
7 that it would have passed this Act and each section, sentence,
8 clause or phrase thereof, irrespective of the fact that any one or
9 more sections, sentences, clauses or phrases be declared unconsti-
10 tutional or invalid.

11 SECTION 19. Effective date. This Act shall take effect
12 upon its approval.

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*As per
leasehold.*

House ~~OKs~~ Tax Break For Lessee

Amended 21 March 64

The House passed 48 to 0 and sent to the Senate yesterday the bill to permit leaseholders to deduct State real property taxes in computing their State and Federal income taxes.

It would mean a tax saving for Hawaii's 11,000 leaseholders, and is expected to clear the Senate with no trouble.

* * *

THE BILL, HB9, was introduced on the opening day of the session by Speaker Elmer F. Cravalho and signed by 21 other Democrats. It amends present State law to provide that where land is leased for residential purposes for 20 years or more, the lessee (or sublessee) shall be regarded as the "owner" of the land, for real property tax purposes.

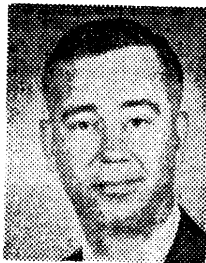
That means the State would bill the lessee—and not the owner—for the real property taxes on the land, and taxes paid would be deductible when computing State and Federal income taxes. They aren't deductible now.

Labor Backs HB9 ^{HA A major of} _{Public Parade}

The Central Labor Council is formally backing the bill to make leaseholders' real property taxes deductible from State and Federal income taxes.

"This bill (HB9) is identical to the one that Rep. David C. McClung introduced last year and passed the House but died in the Senate Ways and Means Committee," said Harry Boranian, executive secretary of the AFL-CIO organization.

"It does the same thing that U. S. Sen. Fong has failed to accomplish through his moves to amend the federal tax code."



McClung



U.S. Approves Leasehold Tax Deductions

HA 13 March 1964

By BUCK BUCHWACH
Advertiser Managing Editor

Hawaii's 11,000 residential leaseholders should soon be able to deduct, on both their State and Federal income tax returns, the real property taxes they pay on the land.

At present, a leaseholder pays the cost of land taxes to the landowner, who is billed for such taxes by the State. Neither Hawaii nor Federal laws currently permit lessees of residential homesites to deduct State taxes on land from their gross income totals. That

privilege is reserved for landowners.

However, the Internal Revenue Service has advised the State Legislative Reference Bureau that a bill pending in the current Hawaii Legislature, changing the status of leaseholders, would enable lessees to de-

duct such taxes from their gross income totals on both State and Federal returns.

* * *

THE PENDING measure is House Bill 9, which has received its needed urgency label from both houses and should encounter little opposition in passage on its

merits, now that it has Internal Revenue Service blessing.

HB9 is a Democratic Party-sponsored measure, introduced on the first day of this session by Speaker Elmer F. Cravalho and signed by 21 other Democrats. It amends present

State law to provide that where land has been leased for residential purposes for a term of 20 years or more, the lessee (or sublessee) shall be regarded as the "owner" of the land, for real property tax purposes only.

That means the State

would bill the lessee for the real property taxes on the land—and taxes paid would be deductible when computing both State and Federal income taxes.

* * *
HOUSE BILL 9 would also save landowners the \$35,000

See Exemption on A-4, Col. 4

U.S. OKs Leasehold Tax Break

Continued from Page 1

a year total they now pay in State excise taxes on the money they collect from lessees for real property taxes. That money is classed as income by the State, and landowners pay the 3½ per cent gross income tax on it . . . even though they are really just transmitting the real property tax money from the lessee to the State.

* * *
THE NEW RULING from the Internal Revenue Service was prompted by a request from Tom Dinell, director of Hawaii's Legislative Reference Bureau. On Feb. 11, he wrote to Mortimer M. Caplin, IRS commissioner, and advised him that some Hawaii legislators were contemplating introducing a bill amending present Hawaii State law affecting the real property tax status of lessees.

He asked Caplin whether the proposed change would satisfy the requirements of the Internal Revenue Service for deductibility of State taxes on Federal income tax returns.

It apparently would, was the reply on March 4, from the director of the IRS tax rulings division, John W. S. Littleton.

* * *
THE TAX legislative counsel in the office of the Sec-

retary of the Treasurer concurred the next day, although he suggested there might be some slight ambiguity with another section of the law covering deductibility of taxes paid on homes built on leasehold land.

At present, a lessee can deduct real property taxes on his home if his lease runs for at least five years. It's probable the minimum lease period will have to be

the same for both house and lot, but this is considered a minor change that can be made in House Bill 9 without any trouble.

* * *

HOW MUCH of a windfall might an individual lessee expect if House Bill 9 is passed?

Depends on how much tax he's paying on his homesite, and what tax bracket he's in.

For instance, if you're paying \$200 a year in land taxes, and you're in the 25 per cent tax bracket, you'd annually save about \$50 in Federal income taxes and perhaps \$5 in State income taxes.

State Tax Collector Edward Burns said last night that the loss in State revenues from passage of HB 9 "wouldn't be significant."

He figures real property

taxes may decline about \$15,000 (because of higher home exemptions for some taxpayers), the general excise revenues may drop by the aforementioned \$35,000 now paid by landowners who transmit the tax from lessees to the State, and gross income tax receipts may go down "a small fraction."

"There's not enough to worry about," said Burns.

*Hon. Adv.
Advised*

March 12, 1964

✓ Mr. Wallace Mitchell
The Honolulu Advertiser
605 Kapiolani Boulevard
Honolulu, Hawaii 96813

Dear Wally:

It seems there's always a new wrinkle on the Maryland Land Law battle. This time, it has been proposed by an attorney for one of the estates that Federal legislation be enacted to treat gains from the sale of leased land, under a Maryland-type law, as a capital gain rather than be taxed as ordinary income.

Enclosed is a copy of a letter to John Robinson on this proposal, along with a copy of a letter from the Treasury Department saying that such legislation is not necessary since such gains would be treated as capital gains under existing law.

The next to last paragraph of my letter to Robinson wraps up my thought on this proposal.

Aloha and best wishes.

Sincerely,

THOMAS P. GILL
Member of Congress

Enclosure: 3/11/64 ltr to Robinson w/Treasury ltr
TPG:pd/mn
bcc: Robinson

*Mr. Pacific
Business News
Ketchikan*

March 12, 1964

✓ Mr. John Ramsey, Editor
Pacific Business News
639 Waikamilo Road
Honolulu, Hawaii 96817

Dear John:

It seems there's always a new wrinkle on the Maryland Land Law battle. This time, it has been proposed by an attorney for one of the estates that Federal legislation be enacted to treat gains from the sale of leased land, under a Maryland-type law, as a capital gain rather than be taxed as ordinary income.

Enclosed is a copy of a letter to John Robinson on this proposal, along with a copy of a letter from the Treasury Department saying that such legislation is not necessary since such gains would be treated as capital gains under existing law.

The next to last paragraph of my letter to Robinson wraps up my thought on this proposal.

Aloha and best wishes.

Sincerely,

THOMAS P. GILL
Member of Congress

Enclosure: 3/11/64 ltr to Robinson w/Treasury ltr
TPG:pd/mn
bcc: Robinson

*Gen. Star-Bull.
deduct*

March 12, 1964

✓ Mr. George West
The Honolulu Star-Bulletin
605 Kapiolani Boulevard
Honolulu, Hawaii 96813

Dear George:

It seems there's always a new wrinkle on the Maryland Land Law battle. This time, it has been proposed by an attorney for one of the estates that Federal legislation be enacted to treat gains from the sale of leased land, under a Maryland-type law, as a capital gain rather than be taxed as ordinary income.

Enclosed is a copy of a letter to John Robinson on this proposal, along with a copy of a letter from the Treasury Department, saying that such legislation is not necessary since such gains would be treated as capital gains under existing law.

The next to last paragraph of my letter to Robinson wraps up my thought on this proposal.

Aloha and best wishes.

Sincerely,

THOMAS P. GILL
Member of Congress

Enclosure: 3/11/64 ltr to Robinson w/Treasury ltr
TPG:pd/mn
bcc: Robinson

LEGISLATIVE REFERENCE BUREAU
STATE OF HAWAII

UNIVERSITY OF HAWAII
HONOLULU, HAWAII 96822

TOM DINELL
DIRECTOR

March 12, 1964

Put in file
MAR 16 1964

✓ Honorable Thomas P. Gill
United States Representative
1322 New House Office Building
Washington, D. C. 20000

Dear Representative Gill:

Enclosed is a copy of a memorandum which we have distributed to members of the Legislature concerning the deductibility of property taxes by an occupant-lessee for federal income tax purposes. The memorandum includes the Bureau's original letter and the replies of the U. S. Treasury Department officials.

Thank you so very much for your assistance in obtaining such prompt replies from the Internal Revenue Service and the U. S. Treasury Department.

Sincerely yours,

Tom

Tom Dinell
Director

TD:my
Enc.

LEGISLATIVE REFERENCE BUREAU
STATE OF HAWAII

UNIVERSITY OF HAWAII
HONOLULU, HAWAII 96822

TOM DINELL
DIRECTOR

March 11, 1964

MEMORANDUM

TO: Members of the Second Legislature of
the State of Hawaii

SUBJECT: Deductibility of Property Taxes by an
Occupant-Lessee for Federal Income Tax
Purposes; Request No. B-0190.

The Legislative Reference Bureau on February 11, 1964, requested an opinion from Mr. Mortimer M. Caplin, Commissioner of the United States Internal Revenue Service, as to whether certain specified amendments to the Revised Laws of Hawaii 1955 would fulfill the requirements that property taxes be imposed on the occupant-lessee and therefore be deductible from gross income when computing the federal income tax.

The Bureau's letter to the Commissioner, the reply of the Director of the Tax Rulings Division of the Internal Revenue Service, and the comments of the Tax Legislative Counsel in the Office of the Secretary of the Treasury are reproduced below for your convenience.



Tom Dinell
Director

* * * *

LETTER FROM THE LEGISLATIVE REFERENCE BUREAU DATED FEBRUARY 11, 1964, TO THE COMMISSIONER OF THE INTERNAL REVENUE SERVICE:

Please consider this as a request for an opinion from your office by the Legislative Reference Bureau. The Legislative Reference Bureau is a research organization for the Legislature of the State of Hawaii. Recently, there has been some interest shown by the Hawaii legislators in the peculiar situation we have in Hawaii, to-wit: although much of the land on Oahu is developed by large estates for residential purposes on long-term leases or is leased to developers for development on long-term leases, the lessees or sub-lessees who are the

actual occupants of the land and who actually pay the state property taxes are not allowed to deduct these taxes from their gross income when computing their federal income taxes. We suspect that this situation obtains from the following:

(1) That under Hawaii law, the trustees of the estate are deemed to be the owners of the property and property taxes are assessed against owners by virtue of the following provision:

Section 124-4. Assessment of property; to whom in general. The real property shall be assessed in its entirety to the owner or owners thereof; provided, that where land has been leased for a term of five years or more for residential purposes, the lessee or his successor in interest, holding the land for such term under such lease and using the same for residential purposes, may be considered an owner with respect to the residential buildings owned by him on such land, provided notice and claim for exemption is given pursuant to sections 128-12 and 128-14.5. For the purposes of this chapter, residential buildings may be deemed to be owned by a lessee or his successor in interest notwithstanding any reversionary interest therein of the lessor.

For the purposes of this chapter, life tenants, executors, administrators, trustees, guardians or other fiduciaries may be, and persons holding government property under an agreement for the conveyance of the same to such persons shall be considered as owners as to any real property held or controlled by them as such. Lessees holding under any government lease shall be considered as owners during the time any real property is held or controlled by them as such, as fully provided in section 128-22. Lessees holding any real property under a lease for a term of fifteen years or more and having an option granted by the lease or conferred by law to purchase the fee, and persons holding any real property under an agreement to purchase the same, shall be considered as owners during the time the real property is held or controlled by them as such; provided the lease or the agreement to purchase (1) shall have been recorded in the bureau of conveyances, and (2) shall provide that the lessee or

purchasers, as the case may be, shall pay the real property taxes levied on the property. (Sec. 128-4, Revised Laws of Hawaii 1955, as amended by Act 142, Session Laws of Hawaii 1963.)

(2) Federal Income Tax Regulations Sec. 1.164-1 which reads:

Sec. 1.164-1. Deduction for Taxes. Except as otherwise provided in this section and in sections 1.164-2 to 1.164-8, inclusive, taxes imposed by the United States, any State, Territory, possession of the United States, or a political subdivision of any of the foregoing, or by any foreign country, are deductible from gross income for the taxable year in which paid or accrued, according to the method of accounting used in computing taxable income. See section 461 for the general rule for taxable year of deduction. Amounts paid to States or Territories under secured-debts laws in order to render securities tax-exempt are deductible. Automobile license fees are ordinarily taxed. Postage is not a tax. In general, taxes are deductible only by the person upon whom they are imposed. See section 164(d) and Sec. 1.164-6 for apportionment of taxes on real property between seller and purchaser. For provisions disallowing any deduction for the tax paid at the source on interest from tax-free covenant bonds, see section 1451(f). As amended T. D. 6406, August 15, 1959, 24 F.R. 6406. (underscoring for emphasis) (1 Federal Tax Regulations 1963, Sec. 1.164-1, p. 240)

The Legislature of the State of Hawaii will commence their 30-day budget session on February 19, 1964, and are contemplating amending the Hawaii law so as to impose the state property taxes upon the actual occupant-lessee rather than upon the trustees so as to enable such occupant-lessee to claim a deduction from his gross income when computing his federal income tax. The amendment which will be considered is to amend the first paragraph of the quoted section (section 124-4) to read as follows:

The real property shall be assessed in its entirety to the owner thereof; provided that where land has been leased for a term of five years or more, the real property shall be assessed in its entirety to the lessee or his

March 11, 1964

successor in interest holding the land for such term under such lease; and such lessee or successor in interest shall be deemed the owner of the real property in its entirety for the purposes of this chapter.

Our question then is: Will the above quoted amendment fulfill the requirement that property taxes are imposed on the occupant-lessee and are therefore deductible from gross income when computing the federal income tax? If not, can you suggest appropriate language? We would appreciate any other comments you may wish to make. Because of the shortness of our legislative session, we would appreciate your prompt reply.

LETTER FROM THE DIRECTOR OF THE TAX RULINGS DIVISION, INTERNAL REVENUE SERVICE, DATED MARCH 4, 1964, TO THE LEGISLATIVE REFERENCE BUREAU:

Your letter of February 11, 1964 inquires whether an occupant-lessee of real property in Hawaii will be entitled to deduct real estate taxes under section 164 of the Internal Revenue Code of 1954, if the first paragraph of section 128-4, Revised Laws of Hawaii, 1955, as amended, is revised to read as follows:

The real property shall be assessed in its entirety to the owner thereof; provided that where land has been leased for a term of five years or more, the real property shall be assessed in its entirety to the lessee or his successor in interest holding the land for such term under such lease; and such lessee or successor in interest shall be deemed the owner of the real property in its entirety for the purposes of this chapter.

Section 128-4 of the Hawaiian law currently reads, in pertinent part, as follows:

"Section 128-4. Assessment of property; to whom in general. The real property shall be assessed in its entirety to the owner or owners thereof; provided, that where land has been leased for a term of five years or more for residential purposes, the lessee or his successor in interest, holding the land for such term under such lease and using the same for residential purposes, may be

Members of the Second
Legislature of the
State of Hawaii

-5-

March 11, 1964

considered an owner with respect to the residential buildings owned by him on such land, provided notice and claim for exemption is given pursuant to sections 128-12 and 128-14.5. For the purposes of this chapter, residential buildings may be deemed to be owned by a lessee or his successor in interest notwithstanding any reversionary interest therein of the lessor."

As you know, section 164 of the 1954 Code provides for the deduction of taxes paid or accrued within the taxable year.

Section 1.164-1 of the Income Tax Regulations provides that, in general, taxes are deductible only by the person upon whom they are imposed.

Since the proposed amendment to section 128-4, Revised Laws of Hawaii, 1955, causes real property taxes to be imposed upon the lessee for a term of five years or more, or his successor in interest, enactment of the amendment will entitle that lessee or his successor in interest to deduct under section 164 of the Internal Revenue Code of 1954 the real estate taxes so imposed upon him and paid or incurred by him.

LETTER FROM THE TAX LEGISLATIVE COUNSEL IN THE OFFICE OF THE SECRETARY OF THE TREASURY DATED MARCH 5, 1964, TO THE LEGISLATIVE REFERENCE BUREAU:

I have examined your letter of February 11 to Commissioner Caplin and reply thereto by Mr. John W. S. Littleton, Director, Tax Rulings Division.


Your letter requested an opinion whether a lessee of real property in Hawaii would be entitled to deduct real estate taxes under section 164 of the Internal Revenue Code of 1954, if the first paragraph of section 128-4 of the Revised Laws of Hawaii, 1955, is amended as specified in your letter. In reply, Mr. Littleton advised that, in general, taxes are deductible only by the person upon whom they are imposed, and that the proposed amendment to section 128-4 would cause real property taxes to be imposed upon the lessee for a term of 5 years or more. Therefore, enactment of the amendment to section 128-4 would entitle such lessee to deduct under section 164 of the Internal Revenue Code of 1954 the real estate taxes so imposed upon him.

Members of the Second
Legislature of the
State of Hawaii

-6-

March 11, 1964

This office interposed no objection to Mr. Littleton's letter. However, I would like to call your attention to a possible ambiguity in section 128-4 of the Revised Laws of Hawaii which may arise because of the difference between the language of the proposed amendment of the first paragraph of section 128-4 (dealing with lessees under 5-year leases) and the present language of the second sentence of the second paragraph of section 128-4 (dealing with lessees under 15-year leases). In order to avoid this possible ambiguity, may I suggest that the language of the second paragraph of section 128-4 be revised to conform fully to the language of the first paragraph as it is proposed in your letter to be amended.



Maryland file

March 11, 1964

✓ Mr. John H. Robinson
440 Merchandise Mart Bldg.
198 South Hotel Street
Honolulu, Hawaii 96813

Dear John:

Last fall, you forwarded from our Honolulu office a proposal for Federal legislation which would amend the Internal Revenue Code so that the sale of property under a statutory option, such as included in the "Maryland Law," would be taxed to the landowner at capital gains rates.

The general summary of the proposal read as follows:

"Tax treatment of gain from a sale of leased land pursuant to the exercise by a lessee of a statutory option"

Attached hereto is a draft of proposed Federal legislation to afford income tax protection to landowners in Hawaii in the event of the future enactment in Hawaii of legislation similar to the so-called Maryland Land Law which was considered at the 1963 session. A copy of the last form of the so-called Maryland Land Law considered (but not passed) by the Hawaii Legislature in 1963 is also attached hereto.

The general scheme of the draft is to treat a sale of leased land pursuant to the exercise by a lessee of a statutory option as the equivalent of an involuntary conversion of property used in the trade or business and not as a sale of property held primarily for sale to customers in the ordinary course of trade or business."

Mr. John H. Robinson
March 11, 1964
PAGE 2

It was my impression at the time that the proposal was not only not needed, but probably couldn't pass the Congress. However, I forwarded the proposal, including the draft bill, to the Treasury for an opinion. They have been quite busy with the new tax bill and have just recently been able to analyze the proposal and answer our query. The letter from Donald C. Lubick, Tax Legislative Counsel, is enclosed.

While the letter is self-explanatory, it does repeat what we have said many times: Sales pursuant to the Maryland Bill would be entitled to capital gains treatment; the Federal tax legislation suggested is not only unneeded but too broad and, hence, objectionable. Such a bill would be opposed by the Treasury and, hence, would in all probability die.

I hope that this note from Mr. Lubick will once again lay the ghost of the Federal tax argument against the Maryland Bill. It reinforces my suspicion that such arguments are mainly for the purpose of casting doubt and creating delay.

Please pass this information along to the landowner attorney who gave you the proposal in the first place. I hope this will be of some guidance to him.

Aloha,

THOMAS P. GILL
Member of Congress

TPG:mn
Enclosure: 3/6/64 Lubick ltr
bcc: Hulten
McClung
Abe
Donahue



OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON

MAR 7 1964

MAR - 6 1964

Dear Tom:

I have had a chance to review the tax proposal which you sent me last Fall which would give capital gains treatment as a section 1231 involuntary conversion to the gain realized by a lessor on the purchase by the lessee of the property pursuant to a statutory option. You have copies of our previous correspondence with Mr. McClung. This indicates that in the case of normal liquidation by Hawaiian landowners of their holdings through exercise of a statutory right of purchase by the tenants, the landowners would not be in the trade or business of selling real estate. Therefore, they would be entitled to capital gains treatment. Since that is the situation, the legislation proposed is unnecessary. The legislation proposed, however, is more than unnecessary; it is also too broad. For example, a landowner engaged in the business of constructing and selling houses on his land, operating through long-term leases, could engage in this subdivision activity with income at capital gains rates rather than ordinary income. We do not think that Federal income tax considerations are any obstacle to enactment of the Hawaiian legislation providing for statutory redemption. An amendment to the Internal Revenue Code would be unnecessary.

Best wishes.

Sincerely,

Donald C. Lubick
Tax Legislative Counsel

Honorable Thomas P. Gill
House of Representatives
Washington, D. C. 20515



Manlyland land

OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON

MAR 6 1964

MAR - 5 1964

Dear Tom:

Here are copies of letters on the matter
of real property taxes.

Best wishes.

Sincerely,

Donald C. Lubick
Tax Legislative Counsel

Honorable Thomas P. Gill
House of Representatives
Washington, D. C. 20515

Enclosures



OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON

MAR - 5 1964

Dear Tom:

Here are copies of letters on the matter
of real property taxes.

Best wishes.

Sincerely,

(Signed) Don

Donald C. Lubick
Tax Legislative Counsel

Honorable Thomas P. Gill
House of Representatives
Washington, D. C. 20515

Enclosures



OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON

MAR - 5 1964

Dear Mr. Doi:

I have examined your letter of February 11 to Commissioner Caplin and reply thereto by Mr. John W. S. Littleton, Director, Tax Rulings Division.

Your letter requested an opinion whether a lessee of real property in Hawaii would be entitled to deduct real estate taxes under section 164 of the Internal Revenue Code of 1954, if the first paragraph of section 128-4 of the Revised Laws of Hawaii, 1955, is amended as specified in your letter. In reply, Mr. Littleton advised that, in general, taxes are deductible only by the person upon whom they are imposed, and that the proposed amendment to section 128-4 would cause real property taxes to be imposed upon the lessee for a term of 5 years or more. Therefore, enactment of the amendment to section 128-4 would entitle such lessee to deduct under section 164 of the Internal Revenue Code of 1954 the real estate taxes so imposed upon him.

This office interposed no objection to Mr. Littleton's letter. However, I would like to call your attention to a possible ambiguity in section 128-4 of the Revised Laws of Hawaii which may arise because of the difference between the language of the proposed amendment of the first paragraph of section 128-4 (dealing with lessees under 5-year leases) and the present language of the second sentence of the second paragraph of section 128-4 (dealing with lessees under 15-year leases). In order to avoid this possible ambiguity, may I suggest that the language of the second paragraph of section 128-4 be revised to conform fully to the language of the first paragraph as it is proposed in your letter to be amended.

Sincerely yours,

Donald C. Lubick
Tax Legislative Counsel

Mr. Herman S. Doi
Legislative Reference Bureau
University of Hawaii
Honolulu, Hawaii



U.S. TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

AIRMAIL

Mailed 1/24/64

IN REPLY REFER TO
T:R:I-VSN-3

Mr. Herman S. Doi
Legislative Reference Bureau
University of Hawaii
Honolulu, Hawaii

Dear Mr. Doi:

Your letter of February 11, 1964 inquires whether an occupant-lessee of real property in Hawaii will be entitled to deduct real estate taxes under section 164 of the Internal Revenue Code of 1954 if the first paragraph of section 128-4, Revised Laws of Hawaii, 1955, as amended, is revised to read as follows:

The real property shall be assessed in its entirety to the owner thereof; provided that where land has been leased for a term of five years or more, the real property shall be assessed in its entirety to the lessee or his successor in interest holding the land for such term under such lease; and such lessee or successor in interest shall be deemed the owner of the real property in its entirety for the purposes of this chapter.

Section 128-4 of the Hawaiian law currently reads, in pertinent part, as follows:

"Section 128-4. Assessment of property; to whom in general. The real property shall be assessed in its entirety to the owner or owners thereof; provided, that where land has been leased for a term of five years or more for residential purposes, the lessee or his successor in interest, holding the land for such term under such lease and using the same for residential purposes, may be considered an owner with respect to the residential buildings owned by him on such land, provided notice and claim for exemption is given pursuant to sections 128-12 and 128-14.5. For the purposes of this chapter, residential buildings may be deemed to be owned by a lessee or his successor in interest notwithstanding any reversionary interest therein of the lessor."

Mr. Herman S. Doi

-2-

As you know, section 164 of the 1954 Code provides for the deduction of taxes paid or accrued within the taxable year.

Section 1.164-1 of the Income Tax Regulations provides that, in general, taxes are deductible only by the person upon whom they are imposed.

Since the proposed amendment to section 128-4, Revised Laws of Hawaii, 1955, causes real property taxes to be imposed upon the lessee for a term of five years or more, or his successor in interest, enactment of the amendment will entitle that lessee or his successor in interest to deduct under section 164 of the Internal Revenue Code of 1954 the real estate taxes so imposed upon him and paid or incurred by him.

Very truly yours,

Director, Tax Rulings Division



OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON

February 26, 1964

FEB 27 1964

Maryland

Dear Tom:

I have had a preliminary discussion of the letter you sent me on February 18 with the people working on the matter at the Internal Revenue Service. Our offhand view is that the proposed legislation ought to accomplish the purpose intended, that of allowing a deduction for property taxes to the lessee under the long-term lease. I have asked that a copy of the formal reply be cleared through me before it is sent and I will see that you get a copy.

Best regards.

Sincerely,

Donald C. Lubick
Tax Legislative Counsel

Honorable Thomas P. Gill
House of Representatives
Washington, D. C. 20515



OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON

February 26, 1964

Dear Tom:

I have had a preliminary discussion of the letter you sent me on February 18 with the people working on the matter at the Internal Revenue Service. Our offhand view is that the proposed legislation ought to accomplish the purpose intended, that of allowing a deduction for property taxes to the lessee under the long-term lease. I have asked that a copy of the formal reply be cleared through me before it is sent and I will see that you get a copy.

Best regards.

Sincerely,

(Signed) Don

Donald C. Lubick
Tax Legislative Counsel

Honorable Thomas P. Gill
House of Representatives
Washington, D. C. 20515

February 18, 1964

Mr. Donald Lubick
Tax Legislative Counsel
Department of the Treasury
Washington 25, D.C.

Dear Don:

Enclosed is a copy of the letter we
discussed on the telephone last Friday.

I would appreciate your thoughts on
this.

Aloha and regards.

Sincerely,

THOMAS P. GILL
Member of Congress

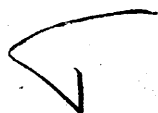
Enclosure: 2/11/64 Doi ltr
TPG:pd/mm

~~Microfilm~~
could file ^{without} ^{only}

2/11

① make copy of letter
for Don subic-Trans.

② call Norman Poi
on Monday.



2/14/64

LEGISLATIVE REFERENCE BUREAU
STATE OF HAWAII

UNIVERSITY OF HAWAII
HONOLULU, HAWAII 96822

February 12, 1964

FEB 14 1964

/ Honorable Thomas P. Gill
United States Representative
1322 New House Office Bldg.
Washington, D. C. 20000

Dear Representative Gill:

Enclosed please find a letter we recently sent to the Internal Revenue Service. The contents of the letter are explanatory. We would appreciate whatever you and the other members of Hawaii's Congressional delegation might do in Washington to expedite a reply.

Thank you for your cooperation.

Sincerely yours,



Tom Dinell
Director

TD:jf
Enclosure

LEGISLATIVE REFERENCE BUREAU
STATE OF HAWAII

UNIVERSITY OF HAWAII
HONOLULU 14, HAWAII

COPY

February 11, 1964

Mr. Mortimer M. Caplin, Commissioner
Internal Revenue Service
Twelfth Street and Constitution Ave., N.W.
Washington 25, D. C.

Dear Mr. Caplin:

Please consider this as a request for an opinion from your office by the Legislative Reference Bureau. The Legislative Reference Bureau is a research organization for the Legislature of the State of Hawaii. Recently, there has been some interest shown by the Hawaii legislators in the peculiar situation we have in Hawaii, to-wit: although much of the land on Oahu is developed by large estates for residential purposes on long-term leases or is leased to developers for development on long-term leases, the lessees or sub-lessees who are the actual occupants of the land and who actually pay the state property taxes are not allowed to deduct these taxes from their gross income when computing their federal income taxes. We suspect that this situation obtains from the following:

(1) That under Hawaii law, the trustees of the estate are deemed to be the owners of the property and property taxes are assessed against owners by virtue of the following provision:

Section 124-4. Assessment of property; to whom in general. The real property shall be assessed in its entirety to the owner or owners thereof; provided, that where land has been leased for a term of five years or more for residential purposes, the lessee or his successor in interest, holding the land for such term under such lease and using the same for residential purposes, may be considered an owner with respect to the residential buildings owned by him on such land, provided

February 11, 1964

notice and claim for exemption is given pursuant to sections 128-12 and 128-14.5. For the purposes of this chapter, residential buildings may be deemed to be owned by a lessee or his successor in interest notwithstanding any reversionary interest therein of the lesser.

For the purposes of this chapter, life tenants, executors, administrators, trustees, guardians or other fiduciaries may be, and persons holding government property under an agreement for the conveyance of the same to such persons shall be considered as owners as to any real property held or controlled by them as such. Lessees holding under any government lease shall be considered as owners during the time any real property is held or controlled by them as such, as fully provided in section 128-22. Lessees holding any real property under a lease for a term of fifteen years or more and having an option granted by the lease or conferred by law to purchase the fee, and persons holding any real property under an agreement to purchase the same, shall be considered as owners during the time the real property is held or controlled by them as such; provided the lease or the agreement to purchase (1) shall have been recorded in the bureau of conveyances, and (2) shall provide that the lessee or purchaser, as the case may be, shall pay the real property taxes levied on the property. (Sec. 128-4, Revised Laws of Hawaii 1955, as amended by Act 142, Session Laws of Hawaii 1963.)

(2) Federal Income Tax Regulations Sec. 1.164-1 which reads:

Sec. 1.164-1. Deduction for Taxes. Except as otherwise provided in this section and in sections 1.164-2 to 1.164-8, inclusive, taxes imposed by the United States, any State, Territory, possession of the United States, or a political subdivision of any of the foregoing, or by any foreign country, are deductible from gross income for the taxable year in which paid or accrued, according to the method of accounting used in computing taxable income. See section 461 for the general rule for taxable year of deduction. Amounts

Mr. Mortimer N. Caplin

-3-

February 11, 1964

paid to States or Territories under secured-debts laws in order to render securities tax-exempt are deductible. Automobile license fees are ordinarily taxed. Postage is not a tax. In general, taxes are deductible only by the person upon whom they are imposed. See section 164(d) and Sec. 1.164-6 for apportionment of taxes on real property between seller and purchaser. For provisions disallowing any deduction for the tax paid at the source on interest from tax-free covenant bonds, see section 1451(f). As amended T. D. 6406, August 15, 1959, 24 F.R. 6406. (underscoring for emphasis) (1 Federal Tax Regulations 1963, Sec. 1.164-1, p. 240)

The Legislature of the State of Hawaii will commence their 30-day budget session on February 19, 1964, and are contemplating amending the Hawaii law so as to impose the state property taxes upon the actual occupant-lessee rather than upon the trustees so as to enable such occupant-lessee to claim a deduction from his gross income when computing his federal income tax. The amendment which will be considered is to amend the first paragraph of the quoted section (section 124-4) to read as follows:

The real property shall be assessed in its entirety to the owner thereof; provided that where land has been leased for a term of five years or more, the real property shall be assessed in its entirety to the lessee or his successor in interest holding the land for such term under such lease; and such lessee or successor in interest shall be deemed the owner of the real property in its entirety for the purposes of this chapter.

Our question then is: Will the above quoted amendment fulfill the requirement that property taxes are imposed on the occupant-lessee and are therefore deductible from gross income when computing the federal income tax? If not, can you suggest appropriate language? We would appreciate any other comments you may wish to make. Because of the shortness of our legislative session, we would appreciate your prompt reply.

Sincerely yours,

Herman S. Doi
Researcher

MSD:jf

cc: Mr. V. W. Evans

Senators Daniel K. Inouye & Hiram L. Fong
Congressmen Thomas P. Gill & Spark M. Matsunaga

KANEOHE RANCH CO., LTD.

Kaneohe, Oahu, Hawaii

February 10, 1964

FEB 17 1964

Handwritten: Tom Gill

The Honorable Thomas P. Gill
Member of Congress
1322 New House Office Building
Washington, D. C. 20515

Dear Tom:

My sincere congratulations to you on the excellency of the wording, composition and the thoughts expressed in the article appearing in yesterday morning's paper on the Civil Rights Bill. Without a chance for the individuals affected to improve themselves so as to take advantage of their rights, as you state, little is to be gained from the Bill.

Now that I have expressed admiration for one of your acts, may I take exception to your remarks (which may have been misquoted) about the Portlock leasing situation. According to the paper, you stated that it would be better for the leasehold owners if the Bishop Estate would sell them the property rather than leasing it with the rents they are proposing. On the basis of simple arithmetic, I can't see how I am better off if I have to borrow money at 6% - 6 $\frac{1}{4}$ % on a conventional basis and buy a piece of property, when I can rent it on the basis of 1 $\frac{3}{4}$ %.

I am all for fee simple ownership! I am trying to find some myself. I have one piece on Hawaii and I would like more, but I feel that the course that is being pursued here is the wrong one. The most effective, quickest and most efficient method is to employ Act VI, and for the Government to declare the need of fee simple housing and let the developers bid for the chance of developing. I have already told the Governor that I would be the first to make a bid for such development rights and would be willing to negotiate the percentage of profit if the Government would forego gross income tax on the pyramiding effects of the development, but so far nothing has happened.

Leasehold development is expanding in California and it does afford people who do not want a permanent tenancy to have a much finer piece of property than they could have if they had to expend money for the fee.

The Honorable Thomas P. Gill
Member of Congress
Page 2
February 10, 1964

I am afraid, Tom, that many of the supporters of the plan to do away with leasehold are afraid that if they actively put land in competition with leasehold development, the leasehold system would attract three times the number of buyers, and they haven't got the nerve to take the chance. Therefore, they prefer to adopt punitive measures against the leasehold developer.

If I can be of any help to you, or if you can be of any help to me, in getting the ball rolling on the development of fee simple land on a condemnation basis, please count me in.

Aloha,



H. W. B. White
Vice President

Memorandum for

S-B

1-14-64

Tax Deductions On Leaseholds

The question of income tax deductions for homeowners who build on leased land got little attention when it was raised in Congress last month.

The Senate Finance Committee rejected a proposal to allow lessees to claim a deduction for real property taxes paid on the land they occupy.

Its action was not surprising. The State allows no such deduction. Why, then, should the Federal Government?

It is unlikely that the Legislature, meeting next month in a budget session, will do anything to correct the inequity. The Legislature has its guns trained on the big estates and their leasehold policies. It wants them to sell the land to prospective home builders.

Retaining the discriminatory tax legislation could create another source of pressure in support of the effort to force the estates, and other large property owners, to sell, rather than lease, homesites.

*deduct
lease*

Maryland file

Who pushed for what? where? when?

No Deduction

Lessees Don't Get Land Tax Break From State

By CHUCK FRANKEL

Congress was asked last month to give Hawaii leaseholders a tax break the State itself isn't prepared to give to its own residents.

The question involves real property taxes on land and their deductibility from State and Federal income taxes.

The U.S. Senate Finance Committee last month rejected a proposal to allow Hawaii homeowners whose residences are on leased land to take a Federal income tax deduction for property taxes.

Edward J. Burns, director of taxation for the State, was asked by the Star-Bulletin if the State allows a deduction in computing income tax and, if not, was there any inclination on the part of the Administration to permit such deductions.

Burns replied that the State does not allow leaseholders to deduct taxes paid on the land and that the "matter has not been reviewed by the present administration."

He noted that Hawaii's income tax law of 1957 incorporated the internal revenue code of 1954 which

allows deductions of taxes paid by taxpayers.

"Under this deduction ruling all property taxes are deductible by the person against whom they are assessed," Burns said.

"Real property taxes for land are assessed against the owners of land (lessors), and are not deductible by residential lessees even though they pay the same by lease contract.

"Real property taxes on the value of improvements on residential leased land are deductible from income reported for State income tax purposes, as

such improvements are considered to be owned by the lessees."

U.S. Senator Hiram L. Fong, who pushed for the Federal exemption, said today in Honolulu that he never tried to get a State exemption when he was a member of the Legislature. He said leasehold residential property was not a big problem at the time. He understands that Republican legislators now are interested in getting a State deduction for the taxes paid on land through lessees.

*Author
last*



OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON

October 31, 1963

NOV 1 1963

Dear Tom:

Thank you for sending me the proposed amendment to the Internal Revenue Code. I shall go over it and be in touch with you as soon as we have come to some conclusion.

Sincerely,

A handwritten signature in dark ink, appearing to read "DL", written over the word "Sincerely,".

Donald C. Lubick
Tax Legislative Counsel

Honorable Thomas P. Gill
House of Representatives
1322 New House Office Building
Washington 25, D. C.



OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON

October 31, 1963

Dear Tom:

Thank you for sending me the proposed amendment to the Internal Revenue Code. I shall go over it and be in touch with you as soon as we have come to some conclusion.

Sincerely,

(Signed) Don

Donald C. Lubick
Tax Legislative Counsel

Honorable Thomas P. Gill
House of Representatives
1322 New House Office Building
Washington 25, D. C.

October 28, 1963

Mr. Donald C. Lubick
Tax Legislative Counsel
Department of the Treasury
Washington, D.C.

Dear Don:

Someday (Christmas afternoon?) when you are not pressed for time, look this over and let me know what you think.

This material was put together by an attorney for one of the estates who opposed the Maryland Bill last spring. The reasons for this effort at this time are not clear, but I can guess at a few.

Since your office is likely to be hit with this question, and others like it, before too many months, perhaps we can steal a march on the problem now.

Good luck amongst the apple trees!

Aloha,

THOMAS P. GILL
Member of Congress

Enclosure: "Tax treatment of gain from a sale of leased land pursuant to the exercise by a lessee of a statutory option"

TPG:mm
bcc: Robinson

2/14/64

Tel. Call Don Lubic. Hasin't seen LRB request but will check with Caplin. I will send him a copy. Says off hand that he thinks the state can affect the deductibility by changing the tax incidence. Pointed out that this would probably mean that the land lord, on renegotiation, would raise the rental to compensate for the increased deductibility.

~~XXXXXXXXXXXX~~

I should find out who sponsored the amendment and raise question:

- (1) Is it urgency material, or does it go thru with majority vote?
- (2) Is the lease term mentioned (5 yrs) too short?
- (3) What is the effect of the incidence of taxes in the lease instrument?

Lubic also said that Treas argued against Fong's bill to amend the revenue code on the basis that the state could achieve the same effect by amending its law.

t.

10/28

Hold Pending
Subic letter



land
The T

(1)

Tax treatment of gain from a sale of
leased land pursuant to the exercise
by a lessee of a statutory option

Attached hereto is a draft of proposed Federal legislation to afford income tax protection to landowners in Hawaii in the event of the future enactment in Hawaii of legislation similar to the so-called Maryland Land Law which was considered at the 1963 session. A copy of the last form of the so-called Maryland Land Law considered (but not passed) by the Hawaii Legislature in 1963 is also attached hereto.

The general scheme of the draft is to treat a sale of leased land pursuant to the exercise by a lessee of a statutory option as the equivalent of an involuntary conversion of property used in the trade or business and not as a sale of property held primarily for sale to customers in the ordinary course of trade or business.

Section 1 would amend section 1231(a) and section 2 would amend section 1231(b) of the 1954 Code. Section 1231 of the 1954 Code contains the provisions which give capital gain treatment to gains from sales or exchanges of property used in the trade or business. Section 2 would add a new paragraph (5) to section 1231(b).

The basic operative provisions of the new paragraph (5) are in subparagraph (A). Subparagraph (A) provides that under specified circumstances the gain realized by a lessor by reason of the

see dup file

exercise of a statutory option shall be treated as a gain on the sale of property used in the trade or business of the lessor and not as a sale of property held primarily for sale to customers in the ordinary course of trade or business. One of the specified circumstances is that there be a designated holding period. The duration of the holding period is left blank in the draft. It is suggested that a 10-year holding period would be appropriate.

Subparagraph (B) of the new paragraph (5) contains definitions. The definition of "lessor" is broad enough to include the fee simple owner of land as to which a statutory option is exercised and also to include any sublessor or other person entitled to share in rents or subrents of such land. The purpose of such a definition is to give any such sublessor or other person (as well as the fee simple owner) capital gain treatment of any payment which might be made to such sublessor or other person by reason of the exercise of the statutory option. However, the holding period is the holding period of the fee simple owner, without regard to the period of the interest of such sublessor or other person.

One of the most difficult problems relates to tacking, for the purpose of determining the holding period. Subparagraph (C) of the new paragraph (5) provides that tacking shall be determined under the rules of section 1223 of the 1954 Code. Section 1223

sets forth the general provisions for tacking and the determination of the holding period of property. Subparagraph (C) also provides that, if land shall have been acquired by a fee simple owner from a decedent or from a donor, the period of holding by the decedent or the donor and any period of holding by a trust estate created by the decedent or by the donor shall be included for the purpose of determining the holding period of the fee simple owner.

Subparagraph (D) of the new paragraph (5) contains a provision to the effect that the new paragraph (5) shall not apply with respect to any transaction covered by section 1055 of the 1954 Code. Section 1055 was incorporated into the 1954 Code by the enactment of the so-called Friedel Bill on April 10, 1963. Section 1055 is applicable to so-called ground rents in Maryland, under certain specified circumstances, one of which is that the right of purchase by a leaseholder must be by the payment of a determined or determinable amount, and another of which is that the lessor's interest must be primarily a security interest. It is recognized that section 1055 would not be applicable under the so-called Maryland Land Law as considered by the Hawaii Legislature. Subparagraph (D) may not be necessary, because the scopes of section 1055 and of the new paragraph (5) are mutually exclusive. However, although section 1055 and the new paragraph (5) do not cover the same subject matter, they do cover related subject matters, and it therefore seems desirable to include subparagraph (D)

in order to make it clear that the new paragraph (5) is not intended to impinge upon the scope of section 1055.

It has been suggested by some that a sale pursuant to the lessee's exercise of the statutory option should also be treated as an involuntary conversion for the purposes of Section 1033 of the 1954 Code, especially since Section 14 of the proposed Hawaii statute expressly so classified such a sale for Hawaii net income tax purposes. If this further effect is desired, there could be added to the attached draft of proposed Federal legislation an additional section reading as follows:

Section ____ . Section 1033(a) of the Internal Revenue Code of 1954 is amended by changing the parenthetical clause in the first sentence thereof to read as follows: "(as a result of its destruction in whole or in part, theft, seizure, requisition or condemnation or threat or imminence thereof, or a sale of land to a lessee under the circumstances specified in section 1231(b)(5))".

It will be noted that the draft does not deal with the problems, if any, that might arise for a lessor which is a charitable trust or other tax-exempt organization.

AN ACT

Relating to the tax treatment of the proceeds of the sale of land to a lessee under State or local law.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress Assembled,

Section 1. Section 1231(a) of the Internal Revenue Code of 1954 is amended by changing the parenthetical clause in the first sentence thereof to read as follows: "(as a result of destruction in whole or in part, theft, seizure, an exercise of the power of requisition or condemnation or the threat or imminence thereof, or a sale of land to a lessee under the circumstances specified in subsection (b)(5))".

Section 2. Section 1231(b) of the Internal Revenue Code is amended by adding a new paragraph at the end thereof, to be designated as paragraph (5) and to read as follows:

"(5) Sale Of Land To Lessee Pursuant To State Law.

"(A) The sale to a lessee of the entire interest in land of a lessor shall be considered to be an involuntary conversion of property used in the trade or business or a capital asset of the lessor and shall not be considered to be a sale of property held by the lessor primarily for sale to customers in the ordinary course of his trade or business, irrespective of the number of

such sales in any taxable year, if:

"(i) the lessee has a right to terminate such lease and to acquire the entire interest of the lessor in the land, which right exists by virtue of State or local law and not because of any private agreement or privately created condition, and

"(ii) such lessee exercises his right to purchase such entire interest, and

"(iii) the fee simple owner has held the land for a period in excess of _____ years prior to the date of purchase by the lessee.

"(B) As used in subparagraph (A): the term 'lessor' means and includes any fee simple owner, any sublessor and any person entitled to share in the rents or subrents of the land involved in an involuntary conversion described in subparagraph (A); and the term 'lessee' means and includes the original lessee and any successor who has the right under State or local law to bring about such involuntary conversion.

"(C) The period for which a fee simple owner has held land, within the meaning of clause (iii) of subparagraph (A), shall be determined under the rules of section 1223, except that if said land shall have been acquired by the fee simple owner from a decedent, within the meaning of section 1014, or if said land shall have been acquired by the fee simple owner from a donor,

within the meaning of section 1015 (other than section 1015 (c)), the holding period shall include the period during which said land shall have been held by such decedent or by such donor and also the period if any for which said land shall have been held by an inter vivos or testamentary trust estate created by such decedent or by such donor.

"(D) This paragraph (5) shall not apply with respect to any transaction governed by section 1055."

Section 3. This Act shall take effect upon its approval.

(To be made one and eight copies)

SECOND LEGISLATURE, 196 3
STATE OF HAWAII

H. B. NO.

24
H. D. 3
S. D. 1

A BILL FOR AN ACT

RELATING TO LEASES OF RESIDENTIAL REAL PROPERTY AND THE
PURCHASE OF FEE SIMPLE TITLE THERETO BY THE LESSEE.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 Section 1. Findings and declaration of necessity. The legislature
2 finds that: (1) a limited number of landowners own more than
3 three-quarters of the privately-held land in the State; (2) much
4 of this land is in rapidly developing urban areas; (3) such a con-
5 centration of ownership of private land results in a practical land
6 monopoly, and causes upward pressures on land prices; (4) such pres-
7 sures are made more intensive by the development practices of these
8 large landowners of making land available in rapidly developing
9 areas only as leaseholds and not in fee simple; (5) the ability of
10 a large number of people to acquire fee simple ownership of resi-
11 dential lots at a fair and reasonable price is an important factor
12 which vitally affects the development of the community; (6) the
13 number of residential leaseholds and the proportion these lease-
14 holds constitute of the total number of residential lots have
15 increased at a very rapid rate during the past fifteen years so
16 that today approximately fifteen per cent of all owner-occupied
17 units in the State are on leaseholds and approximately twenty
18 per cent on the most urbanized of the islands; and by 1980 it is
19 likely that more homes will be located on leased than fee simple

1 land; (7) it is also likely that more than eighty per cent of the
2 new residential lots which will become available for owner-occupancy
3 between now and 1980, especially in the most urbanized areas, will
4 be leaseholds unless significant changes are effected; (8) such a
5 limited availability of fee simple land for residential purposes
6 effectively deprives the people of Hawaii who desire to purchase
7 new or relatively new residences of the right to choose whether
8 they wish to own the land or lease the land on which their homes
9 are situated and makes such people live dependently upon the land
10 of others.

11 It is hereby declared as a matter of legislative determination
12 that the scarcity of fee simple houselots within the State of
13 Hawaii and, in particular, in the urban areas, is a matter affected
14 with the public interest and that measures to provide for the right
15 of individuals to purchase the fee simple title to houselots are
16 necessary in furtherance of the general welfare.

17 SECTION 2. Definitions. Unless a difference meaning clearly
18 appears from the use of the following terms as used in this Act,
19 they shall have the following meanings:

20 (a) The term "lease" includes subleases.

21 (b) The term "lessee" includes all persons named in
22 the instrument of lease or sublease as lessees or sublessees
23 and includes any assignees of such persons.
24
25

1 (c) The term "lessor" includes all persons named in the
2 instrument of lease or sublease as lessors or sublessors. It
3 includes the owners of the fee simple title and all other persons
4 ✓ who have an interest of record in the land, including, where
5 appropriate, developers.

6 (d) The term "lease", "lessor" and "lessee", or any pronoun
7 used in place thereof, shall mean and include the masculine or
8 feminine, the singular or plural and jointly and severally,
9 individuals or corporations, and their or each of their respective
10 heirs, successors, legal representatives and assignors, as may
11 be found appropriate to the context of this Act.

12 (e) The term "houselot" means a lot not exceeding one
13 acre in size and devoted to, or used for, or intended for, or
14 permitted for use as single family residential lot.

15 (f) The term "fair market value" means the amount of
16 money that a purchaser willing, but not obliged to buy the
17 property, would pay to an owner willing, but not obliged to
18 sell it, taking into consideration all uses to which the land
19 is adapted or might in reason be applied.

20 (g) The term "residence" shall mean and include residence
21 upon the houselot by the lessee or the ancestors, descendants
22 and an undivorced spouse of a lessee so long as the occupancy
23 for such residence has been under the same lease.
24
25

1 SECTION 3. Option to purchase. Any houselot which is hereafter
2 leased for a term (including any periods for which the lease may
3 be extended or renewed at the option of the lessee) in excess
4 of fifteen years, shall be purchasable in fee simple by the lessee,
5 at his option, in the manner hereinafter provided, at any time
6 after the expiration of five years from the date of the lease or
7 assignment of lease up to the date of expiration thereof, provided
8 that the lessee has occupied the premises as his personal residence
9 for at least five years next preceding the exercise of the option,
10 and is not then in default under his lease.

11 SECTION 4. Exclusions. The provisions of this Act shall not
12 apply to:

X 13 (a) any houselot which was leased and occupied as a resi-
14 dence prior to the effective date of this Act, and to any sublease,
15 assignment, extension or renewal of lease of such houselot.

16 (b) Hawaiian Homes lands within the provisions of Article
17 XI of the Constitution of the State of Hawaii, as amended.

18 SECTION 5. Effect of purchase. The effect of a purchase under
19 this act shall be to vest in the lessee all the right, title and interest
20 of the lessor in and to the houselot, subject however, to all covenants,
21 conditions, easements, reservations and restrictions of record running
22 with the land or those contained in the lease which are not inconsistent
23 with the intent of this act, and shall terminate all the right,
24 title and interest of the lessor, whether such interest be a remainder,
25 vested or contingent, a reversion or other beneficial interest in the

1 property, present or prospective, legal or equitable, provided such
2 lessor be given notice and compensated for his respective interest
3 as herein provided.

4 If the leasehold is subject to any mortgage, lien or encumbrance
5 suffered or permitted by the lessee herein, including but not limited
6 to rights arising through marriage, divorce or assignment, the same
7 shall continue in full force and effect and bind the fee acquired
8 by the lessee in the same order and priority as the same applied
9 to and bound the lessee's immediate previous leasehold interest.

10 SECTION 6. Exercise of option. A lessee desiring to exercise
11 his option to purchase after his lease becomes redeemable as herein
12 provided, shall exercise the same by sending written notice of his
13 intent to exercise said option by registered or certified mail to the
14 lessor and to all other parties in interest of record and those
15 personally known to the lessee. The notice shall identify the
16 date and recording data of the lease, a short description identifying
17 the houselot and the amount of the purchase price offered by the
18 lessee. Where any party in interest is not known to the lessee
19 either as to identity or the nature of his interest or claim, or
20 although known, cannot be found, or constitutes a class of persons
21 too numerous to notify individually, notice to such parties shall
22 be given by publication thereof at least three times in a news-
23 paper of general circulation in the city or county in which said
24 houselot is located.
25

1 Upon mutual agreement of the price and other terms of purchase
2 and upon payment of said price by the lessee, the lessor shall execute
3 and deliver to the lessee a good and sufficient deed, prepared at the
4 expense of the lessee, conveying and vesting in the lessee the fee
5 simple title to the houselot thereby purchased, and the lease there-
6 tofore existing between the parties shall be fully redeemed and
7 terminated. All payments under the lease, including rents, shall
8 continue to be paid by the lessee after delivery of said notice to
9 the lessor up to the time of full payment of purchase price, and any
10 proratable costs or charges arising out of said purchase shall be
11 prorated between the parties as of said date.

12 SECTION 7. Purchase price. The purchase price of the fee
13 interest subject to purchase by the lessee is the fair market value,
14 as herein provided, of such interest determined as of the date of
15 notice to exercise option, undiminished by the value of any interests
16 of sublessors, developers, mortgagees or lienors of the fee interest
17 or of the landowner. Such price as so determined shall be allocated
18 between and paid to the land owner, sublessors, developers, mortgagees
19 or lienors or other claimants as their respective interests may appear.
20 The purchase price may be determined by either mutual agreement,
21 arbitration or court proceeding as set forth herein, but shall not
22 be less than the fair market value of the houselot as determined by
23 the Department of Taxation for real property tax purposes as of the
24 date of execution, renewal or extension of the lease sought to be
25 redeemed.

1 In the determination of the fair market value, there shall
2 first be made an estimate of the fair market value of the land as
3 a fee simple houselot exclusive of any landscaping, walks, drives,
4 walls, fences, buildings and betterments placed upon the land or
5 paid for by a lessee. Such estimates shall be made without
6 reference to the lease or to the rental derived therefrom. From
7 this value there shall be deducted the cost of any other onsite
8 and offsite improvements (other than landscaping, walks, drives,
9 etc.) which have been previously paid for by a lessee. The cost of
10 such onsite and offsite improvements included in the original pur-
11 chase price of the leasehold estate shall be certified to by the
12 developer of the property at the time of the execution of the lease.

13 SECTION 8. Developer's interest. The interest in the purchase
14 price of a developer, sublessor, or other person entitled to share
15 in the lease rentals may be determined by agreement of those en-
16 titled to share in such purchase price. In the absence of such
17 agreement, the interest of a developer, sublessor, or other person
18 entitled to share in the lease rentals shall equal such person's
19 total share in the lease rentals for the remainder of the period
20 during which such person would be entitled to share in the lease
21 rental, discounted to present day value at five per cent per annum.

22 SECTION 9. Arbitration. If the parties cannot agree as to the
23 purchase price within thirty days from the receipt by the lessor of
24 the notice to exercise option, the parties may proceed to determine
25 the same by arbitration, subject to the provisions of Chapter 188,
Revised Laws of Hawaii 1955.

1 SECTION 10. Payment of purchase price. Upon the determination
2 of the purchase price, the lessee shall, within 5 days of such
3 determination, pay to the lessor an earnest money deposit equal to
4 five per cent of said purchase price. After payment of such deposit,
5 the lessee shall be permitted up to ninety days in which to pay the
6 balance of said purchase price. Thereafter, any failure by the lessee
7 to complete the purchase by full payment of the balance due shall,
8 unless extended by the lessor or by the court for good cause, con-
9 stitute a breach of the lessee's agreement to purchase and the lessor
10 shall be entitled to retain the deposited sum as liquidated damages.
11 Until payment in full is made by the lessee, the title shall not
12 pass, rental payments shall not abate and the lease will be deemed
13 to be in full force and effect provided, however, that nothing set
14 forth herein shall preclude the parties from mutually agreeing to
15 any other terms regarding the method of payment, including, but not
16 limited to, the deferral of payments by or through means of purchase
17 money mortgages, agreements of sale, or other forms of secured
18 transactions.

19 SECTION 11. Determination by Court. In the event that:

20 (1) The lessor and lessee cannot agree as to the purchase
21 price and do not submit the same for determination by arbitration
22 within forty-five days from the date of receipt of the notice
23 to exercise option, or

24 (2) The lessor fails or refuses to execute and deliver a
25 deed of conveyance within fifteen days after agreement is reached
as to all terms of the purchase and a tender of full purchase

1 price and demand for conveyance is made by the lessee, or fails
2 or refuses to execute the instruments necessary to effect the
3 purchase agreement, or

4 (3) The lessor is a trustee without power of sale under
5 a will, deed or other instrument for any trust, use or purpose,
6 or is a life tenant with a remainder over, vested or contingent,
7 or is the holder of a defeasible estate, but without power of
8 sale in such trustee, life tenant or holder of a defeasible
9 estate, or is an infant, ward, or incompetent, or any other
10 circumstances occur or exist as to the legal status of the
11 lessor or state of title of the house lot under option, or a
12 dispute exists between lessors regarding the proper allocation
13 of the purchase price, which prolong, preclude or prevent a
14 voluntary conveyance by the lessor of the subject house lot,
15 then the lessor, lessee, or any party in interest hereinabove con-
16 templated may petition the circuit court in the judicial circuit
17 where the house lot is situated for an order of conveyance, for
18 determination of fair market value, for specific performance, or
19 for any other relief as the circumstances require. Every petition
20 shall set forth the date and recording data of the lease, the
21 owner of the house lot and all documents, claims, liens, and
22 interests of record, the location and description of the house lot,
23 the notice and date of exercise of the option to purchase and such
24 other facts and circumstances as may be necessary to properly
25 present the matter to court for the relief sought. A copy of the

1 petition and summons shall be served upon the lessor and all parties
2 in interest of record or personally known to the lessee, either by
3 personal service or by publication, as the case may be, as provided
4 by law for civil cases generally, and as set forth in the Hawaii
5 Rules of Civil Procedure.

6 The Court shall have power to hear and determine all adverse
7 or conflicting claims to the houselot sought to be purchased and to
8 the compensation or price to be paid to the lessor and other parties
9 in interest for conveying and releasing their respective interests
10 in the same.

11 SECTION 12. Abandonment of suit. Whenever any proceedings
12 instituted under the provisions of this Act are abandoned or dis-
13 continued by lessee before final judgment, or if for any cause the
14 lessee fails to complete the purchase upon the terms determined by
15 the court, the lessor shall be entitled in such proceedings to
16 recover from the lessee all such damage as may have been sustained
17 by lessor by reason of the bringing of the proceedings by the lessee,
18 including costs of court, reasonable attorney's fees and other reason-
19 able expenses incurred in connection therewith. Issues of fact
20 arising in connection with any claim for such damage shall be tried
21 by the court without a jury within ten days from the date of the
22 entry of an order or judgment allowing the discontinuance of the
23 proceedings or dismissing the proceedings or denying the right of
24 the lessee to the option. The court may at any stage in the pro-
25 ceedings require the lessee to deposit with the court, as evidence

1 of good faith a sum not to exceed \$500.00 which such sum may be
2 applied to the purchase price, or in the event the lessee fails
3 to complete the purchase, may be applied to the damages as set
4 forth above.

5 SECTION 13. No estoppel or waiver. No lessee qualified to
6 effect the purchase of the fee, shall be estopped by any covenant,
7 term, condition or contract, however worded, from claiming the
8 right granted to him by this Act or otherwise be deemed to have
9 waived such right. Any attempted circumvention of this law with
10 the intent to nullify the provisions hereof shall be null and void
11 and the lessee shall retain all the rights herein provided.

12 SECTION 14. Involuntary conversion. Notwithstanding the
13 repeated execution by a lessor of leases, or renewal or extension
14 of leases of houselots with knowledge that the same may become
15 subject to the provisions of this Act, such lessor shall not be
16 deemed to be a "dealer" in the sale of real property or one holding
17 real property primarily for sale to purchasers in the ordinary
18 course of trade or business; and further, any conveyance of title
19 by a lessor upon the exercise by the lessor upon the exercise by
20 the lessee of the purchase option as herein provided, shall con-
21 stitute and be deemed an involuntary conversion of the lessor's
22 interest in the property so conveyed for the purpose of applicable
23 provisions of the Internal Revenue Code and Chapter 121, Revised
24 Laws of Hawaii 1955, as amended as well as any and all other statutes,
25 rules, regulations, administrative orders and legal interpretations

1 within the Federal and State governments relating to taxation.

2 SECTION 15. Authority for trustees and executors to lease
3 pursuant to this Act. Notwithstanding any limitations in any
4 instrument creating any estate or trust, and regardless of whether
5 such estate or trust was in effect prior to the effective date of
6 this Act, which forbids or restrains the sale of real property of
7 such estate or trust, or which gives to any trustee or trustees a
8 discretionary power of sale, or which restricts or denies the
9 powers of trustees, executors, or officers of such estate or trust
10 to grant leases containing an option to purchase, the trustee,
11 executors or officers of such estate or trust may enter into leases
12 in excess of 15 years and shall convey the property subject to such
13 lease upon the exercise of the option by the lessee as provided
14 herein. Every will or trust instrument now in existence or herein-
15 after executed shall be construed in conformity with the intent
16 and purpose of this Act.

17 SECTION 16. State land. Any law to the contrary notwith-
18 standing, the provisions of this Act shall apply to leases of
19 public land in the same manner as to private land.

20 SECTION 17. Assignments. All leases subject to the provisions
21 of this Act shall be assignable by the lessee without approval or
22 consent of the lessor, provided, however that no such assignment
23 shall be effective to transfer any interest in the lease unless
24 the lessor is given a true executed copy of such assignment or
25 written notice thereof.

1 SECTION 18. Severability. If any section, sentence, clause
2 or phrase of this Act, or its application to any person or other
3 circumstance, is for any reason held to be unconstitutional or
4 invalid, the remaining sections, sentences, clauses and phrases of
5 this Act, or the application of this Act to other persons or cir-
6 cumstances, shall not be affected. The legislature hereby declares
7 that it would have passed this Act and each section, sentence,
8 clause or phrase thereof, irrespective of the fact that any one or
9 more sections, sentences, clauses or phrases be declared unconsti-
10 tutional or invalid.

11 SECTION 19. Effective date. This Act shall take effect
12 upon its approval.

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ASSISTANT SECRETARY

TREASURY DEPARTMENT

WASHINGTON

MAR 21 1963

Dear Mr. Gill:

You have asked for a preliminary and informal judgment as to the effect of H. R. 1597 on the deductibility by tenants in Hawaii of rents reserved under long-term leases of residential property, assuming the passage of legislation in Hawaii to permit the redemption of the rents.

Pursuant to H. R. 1597 any annual or periodic rental under a redeemable ground rent would be treated as deductible interest and the redeemable ground rent would be treated as a mortgage for other purposes, for example, proceeds of sale of property.

Under the bill the definition of a redeemable ground rent is a ground rent with respect to which:

"(1) there is a lease of land which is assignable by the lessee without the consent of the lessor and which (together with periods for which the lease may be renewed at the option of the lessee) is for a term in excess of 15 years,

"(2) the leaseholder has a present or future right to terminate, and to acquire the entire interest of the lessor in the land, by payment of a determined or determinable amount, which right exists by virtue of State or local law and not because of any private agreement or privately created condition, and

"(3) the lessor's interest in the land is primarily a security interest to protect the rental payments to which the lessor is entitled under the lease."

The Senate Finance Committee report language indicates the ground rents to which the bill refers:

"The 'redeemable ground rents' which constitute the arrangements to which the term as used in the bill refers, are agreements in the form of freely assignable leases, as to which there is a statutory right to redeem upon payment of the capitalized value of the rentals reserved in the agreement at a rate not in excess of that

1163
Security Dept

fixed by statute. These leases are usually renewable and are for very long terms. In Maryland, in order to have a statutory right of redemption, the term (including renewals) must be for at least fifteen years and is frequently for 99 years. These arrangements are used primarily as vehicles in the financing of the purchase of real property. An essential characteristic is that in actuality the 'tenant' has the equivalence of fee simple ownership in the land, and the 'landlord' has only a security interest in the property to protect the rental payments to which he is entitled. The landlord does not have the usual liabilities of a landowner for taxes on the property, nor in tort. Upon ejectment of the 'tenant' for nonpayment of the ground rent, the 'tenant' has certain rights to redeem his property by curing his default within a limited period of time (similar to the remedy of a mortgagor with an equity of redemption)."

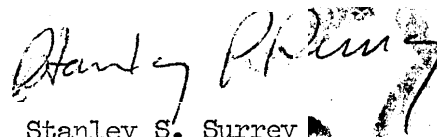
Thus it appears that under the legislation an essential question is whether the tenant is in substance the fee simple owner. If the landlord's interest under the ground lease is solely a security interest for his rentals, in economic substance he is not a fee simple owner. A question of fact is thus presented and whether payment of ground rents in Hawaii under the proposed new Hawaiian legislation would qualify as interest under H. R. 1597 cannot definitively be decided until one knows the economic consequences of the Hawaiian legislation.

However, a number of possibilities should be considered with respect to the proposed Hawaiian legislation which would help establish an economic situation entitling the ground rent to qualify under H. R. 1597. It might be well to provide in the legislation that the leases to which the right of redemption is granted should be freely assignable without consent of the lessor. Assuming its constitutionality, an alternative right in the tenant to redeem by payment of the annual rentals capitalized at a rate of 6 percent (in addition to a price based upon appraised fair market value) would give more of the flavor of a mortgage. The imposition on the tenant possessing the right of redemption of real property taxes on to the land and improvements would also indicate that the tenant is being treated as a fee simple owner under Hawaiian law and would in addition entitle the tenant to a deduction for these taxes. Perhaps this should be done by characterizing the tenant under Hawaiian law as the owner of the land for real property tax purposes, if the lease is one to which the new right of redemption applies.

If in practice because of the right of redemption and these other provisions, the Hawaiian ground rent becomes essentially a financing device, and the tenant has the equivalence of fee simple ownership, then the ground rent payment would be treated as deductible interest. In any event, the possibility of deductibility seems sufficiently real to suggest that the Hawaiian legislation ought to be framed with reference to the definition contained in H. R. 1597.

It is our preliminary view also that if the lease is regarded as a redeemable ground rent under H. R. 1597 because in economic substance the landlord is no longer the fee simple owner, the transfer of land subject to the reservation of a redeemable ground rent would be regarded as a sale by the lessor subject to a mortgage. In that case the lessor could defer payment of tax on the sale through use of the installment method. The lessor can assure himself of the benefits of the installment method, deferring taxation until payment is received, by filing an election with his tax return to the effect that if the lease is treated as a sale, the installment method is elected as to the proceeds. We previously wrote to Mr. McClung that it is not likely that the landlords would be treated as engaged in the trade or business of selling real estate merely because they are forced to redeem property on account of the action of the Hawaiian legislature. Again it is our preliminary view that this result would not be changed under the circumstances outlined in our letter to Mr. McClung even if the entering into a lease is regarded as a sale.

Sincerely yours,


Stanley S. Surrey
Assistant Secretary

Honorable Thomas P. Gill
House of Representatives
1322 New House Office Building
Washington 25, D. C.

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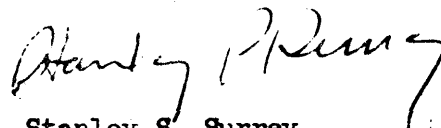
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Sincerely yours,



Stanley S. Surrey
Assistant Secretary

Honorable Thomas P. Gill
House of Representatives
1322 New House Office Building
Washington 25, D. C.

Wayso me...
Taps on leasehold
land

February 5, 1963

✓ Mr. Charles W. Amor
Coordinator
Conference of Filipino Voters
98-1225 Ulune Street
Aiea, Oahu, Hawaii

Dear Charlie:

Thank you for your letter of February 2 in regard to the problem of real property taxes on leasehold land.

Senators Fong and Inouye have jointly introduced Senate Bill 344, and I have taken the liberty of enclosing a copy to you.

Although I have not had the opportunity to study this bill closely, I am fully aware that we have a particular problem here. Perhaps the root of the evil, however, is in the widespread use of the leasehold system in Hawaii.

You may be sure that we will have this matter in mind during the coming session of the Congress.

Again, thank you for bringing this matter to my attention, and if I can be of any further help, please feel free to call on me.

Aloha and best wishes.

Sincerely,

THOMAS P. GILL
Member of Congress

Enclosure

TPG:tn/lh
bcc: Robinson

1/31

get copy of Bill (2)

- Forward me too!

A.

Y 26 1963

Suite 440
Merchandise Mart Bldg.
198 S. Hotel St.
Honolulu, Hawaii

January 23, 1963

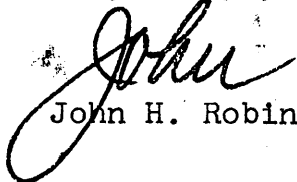
Honorable Thomas P. Gill, M. C.
1322 New House Office Building
Washington 25, D. C.

Dear Tom:

Charles Amor, 98-1225 Ulune St., Aiea, Hawaii, is the president of the Aiea Community Association. He has heard that a bill was introduced in Congress to permit leasees in Hawaii who pay real estate taxes on their leased property to deduct such taxes on Federal income tax returns. Recently I noticed that one of the Senators had introduced such a bill in the Senate.

Will you kindly send a copy of the bill for Mr. Amor's use and let us have any information available to the Hawaii delegation concerning the probable course of the bill?

Very truly yours,


John H. Robinson

JHR:lf ~~XXXXXXXXXXXXXXXXXXXX~~
cc to Mr. Amor

3 copies of bill -

Document room

(3456)

5344 ; H



*This on leasehold
fund*

February 4, 1963

✓ Mr. K. Tim Yee
Vice President and
Assistant General Manager
Kaiser Hawaii-Kai Development Co.
P. O. Box 7068
Honolulu, Hawaii



Dear Tim:

Thank you for sending me your letter of January 22 in regard to the Federal tax problem on leaseholds. As you know, the tax bill currently before the House Ways and Means Committee calls for a great many modifications. We will keep this one in mind.

However, I am sure you will agree that the basis of the problem is really the widespread and unfortunate use of the leasehold system in the Islands.

Thank you for writing.

Aloha and best wishes.

Sincerely,

THOMAS P. GILL
Member of Congress

TPG:ag
cc: John Robinson

JAN 28 1963

KAISER HAWAII-KAI DEVELOPMENT CO.

10



EXECUTIVE OFFICES
Post Office Box No. 7068 Honolulu, Hawaii
Telephone: 362-331 Cable: HAWAIIKAI

January 22, 1963

Honorable Thomas P. Gill
U. S. House of Representatives
1320 New House Office Building
Washington 25, D. C.

Dear Mr. Gill:

FEDERAL TAX DISCRIMINATION AGAINST
HOMEOWNER-LESSEES IN HAWAII

Please refer to Mr. J. Garner Anthony's letter concerning the deductibility of real property taxes paid by homeowner-lessees as announced by the District Director of Internal Revenue in Honolulu.

We concur with Mr. Anthony's conclusion that a simple amendment to Section 164 of the Internal Revenue Code, providing that a lessee of residential land who, under a covenant of the lease, is required to pay all real property taxes, shall be deemed to be the person on whom the taxes are assessed, is necessary to end the disadvantage of Hawaii homeowners on leaseholds in comparison with taxpayers in other states. However, we believe that any lessee obligated to pay such taxes, regardless of the term of his lease, should be entitled to the deduction, rather than only those holding under leases for a term of twenty years or more as advocated by Mr. Anthony.

Passage of the amendment proposed is important to Hawaii and will result in removal of a basically unfair tax burden placed on Hawaii's homeowner-lessees.

Very truly yours,

A handwritten signature in cursive script, appearing to read "K. Tim Yee".

K. Tim Yee
Vice President and
Assistant General Manager

COPY

January 14, 1963

*ways & means
Taxes on
leasehold land
(include files)*

✓ Mr. Joseph R. Pao, President
✓ Hawaiian Pacific Industries, Inc.
914 Ala Moana Boulevard
Honolulu, Hawaii

Dear Mr. Pao:

This will acknowledge receipt of your letter of January 9 in regard to the problem of real property taxes on leasehold land.

I am aware that we have a particular problem in this regard. Perhaps the root of the evil, however, is in the widespread use of the leasehold system in Hawaii.

You may be sure that we will have this matter in mind during the coming session of the Congress.

Thank you for writing.

Aloha and best wishes.

Sincerely,

THOMAS P. GILL
Member of Congress

TPG:ag

HPI

HAWAIIAN PACIFIC INDUSTRIES, INC.

JAN 11 1963
914 Ala Moana, Honolulu, Hawaii

January 9, 1963

13

Honorable Thomas Gill
The United States House of Representatives
Washington, D. C.

Dear Representative Gill:

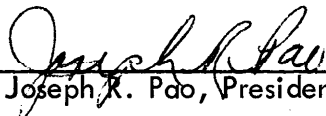
The District Director of Internal Revenue in Honolulu has recently announced that a home owner on lease land cannot deduct real property taxes assessed against the land. This places Hawaii home owners on leaseholds at a disadvantage as compared with other states. It results in a discrimination against our people.

You would do a real service to the people of Hawaii if you would introduce legislation to eliminate this discrimination. It could be done by an amendment to Section 164 of the Internal Revenue Code by providing that a lessee of residential land under a lease who is required to pay all real property taxes shall be deemed to be the person on whom the taxes are assessed.

Your immediate consideration to the aforementioned request shall be greatly appreciated by the people of Hawaii.

Sincerely,

HAWAIIAN PACIFIC INDUSTRIES, INC.



Joseph R. Pao, President

JRP:bkj

Seq. action file.

ROBERTSON, CASTLE & ANTHONY

NOV 4 1963 *See roll to L*

Law Offices
312 Castle & Cooke Building
P. O. Box 3199
Honolulu 1, Hawaii
Telephone: 571941
Wireless "Hermes" Honolulu

November 28, 1962

Thomas P. Gill, Esq.
446 Merchandise Mart Building
Honolulu, Hawaii

Re: Federal Tax Discrimination against
Homeowner-lessees in Hawaii.

Dear Tom:

Although you are not yet sworn in, there is a matter in which you can help our local taxpayers in the next Congress.

The District Director of Internal Revenue in Honolulu has recently announced that a homeowner on leasehold land cannot deduct real property taxes assessed against the land, although the portion of the taxes issued against improvements may be deducted if the homeowner has given notice and claim for exemption as specified in R.L.H. 1955, §128-4. At present, the administration of this ruling is not uniform. Some taxpayers have taken the deductions without challenge from the Revenue Service; others have taken it and had it disallowed.

He takes the position that the taxes can be deducted only by the person on whom they are assessed, and even where a lease of residential land requires the lessee to pay all real property taxes, the assessment on the land is on the landlord and therefore not deductible by the tenant. This is not necessarily substantiated by Internal Revenue Code 1954, §164a.

Except as otherwise provided in this section, there shall be allowed as a deduction taxes paid or accrued within the taxable year.

Regulations, §1.164-1(a) expands the statute:

Except as otherwise provided in this section and in §§1.164-2 to 1.164-8, inclusive,

Thomas P. Gill, Esq.
Page two
November 28, 1962

taxes imposed by the United States, any State, Territory, possession of the United States, or a political subdivision of any of the foregoing, or by any foreign country, are deductible from gross income for the taxable year in which paid or accrued, according to the method of accounting used in computing taxable income
In general, taxes are deductible only by the person upon whom they are imposed. (Emphasis supplied)

Although there is a question whether the code authorizes this interpretation, it probably would be upheld in the courts.

This places Hawaii homeowners on leaseholds at a disadvantage compared with taxpayers in other states. It results in a clear discrimination against our people. You would do a real service to Hawaii if you would introduce in the next session of Congress legislation to eliminate this discrimination. It could be done by a simple amendment to Section 164 of the Internal Revenue Code by providing that a lessee of residential land under a lease for a term of twenty years or more who, under the covenants of the lease, is required to pay all real property taxes, shall be deemed to be the person on whom the taxes are assessed.

I would be glad to review this further with you or anyone you may designate. I realize that the next session of Congress probably will see a thorough overhaul of our revenue laws and that this item is relatively insignificant in the whole program. However, it is important to Hawaii and no one can advance any valid reason against the proposition.

I am writing a similar letter to Senator-elect Inouye and Sparkie Matsunaga.

Sincerely,



J. Garner Anthony

JGA:ms

ROBERTSON, CASTLE & ANTHONY

Law Offices
312 Castle & Cooke Building
P. O. Box 3199
Honolulu 1, Hawaii
Telephone: 571941
Wireless "Hermes" Honolulu

November 28, 1962

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Thomas P. Gill, Esq.
Page two
November 28, 1962

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Sincerely,

J. GARNER ANTHONY
J. Garner Anthony

JGA:ms