

Tax Issues for Foreign Buyers of Hawaii Real Estate

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Disclosure

This presentation is for discussion purposes only
and should not be relied on as tax advice.

Foreign Buyer

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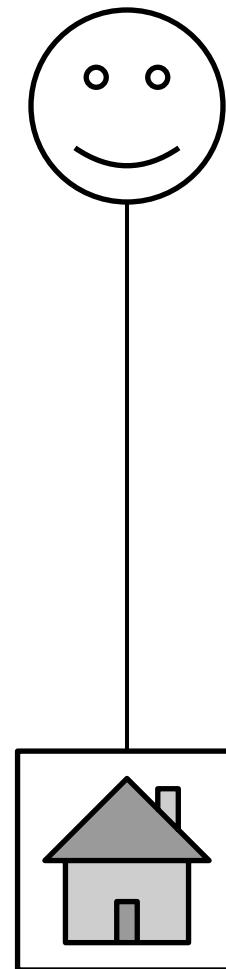
- “Nonresident alien” for U.S. tax purposes is an individual who
 - Is not a U.S. Citizen
 - Is not a U.S. Green Card holder
 - And who doesn’t have “substantial presence” in the U.S.
 - Generally, no substantial presence if the foreign person is in the U.S. for less than 120 days per year
- Nonresident aliens are almost always considered non-Hawaii residents as well

Alternatives for Holding Real Estate

Alternatives for Holding Hawaii Real Estate

1. Direct Ownership by Foreign Individual
2. Hawaii Limited Liability Company
3. Hawaii Corporation
4. Non-U.S. Corporation
5. Hawaii Corporate Sub of Non-U.S. Corporation
6. Hawaii LLC with Individual and Corporate Members
7. Trust

Direct Ownership by Individual



Foreign Individual

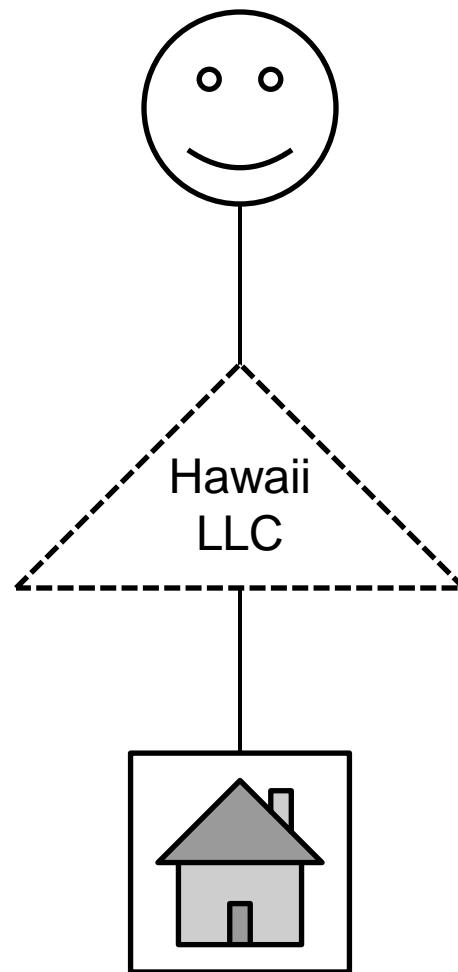
Hawaii Real Estate

Direct Ownership by Individual

Direct Ownership by Foreign Individual

- U.S. and Hawaii estate tax of up to 52% of the property value applies if foreign person dies
- Gift triggers U.S. gift tax of up to 40% of value
- Foreign person must file U.S. and Hawaii tax returns to report any rental or sale income
 - Foreign persons must pay income tax on gross rental income, unless a special election is made
- FIRPTA and HARPTA will apply when the property is sold

Single-Member Hawaii LLC

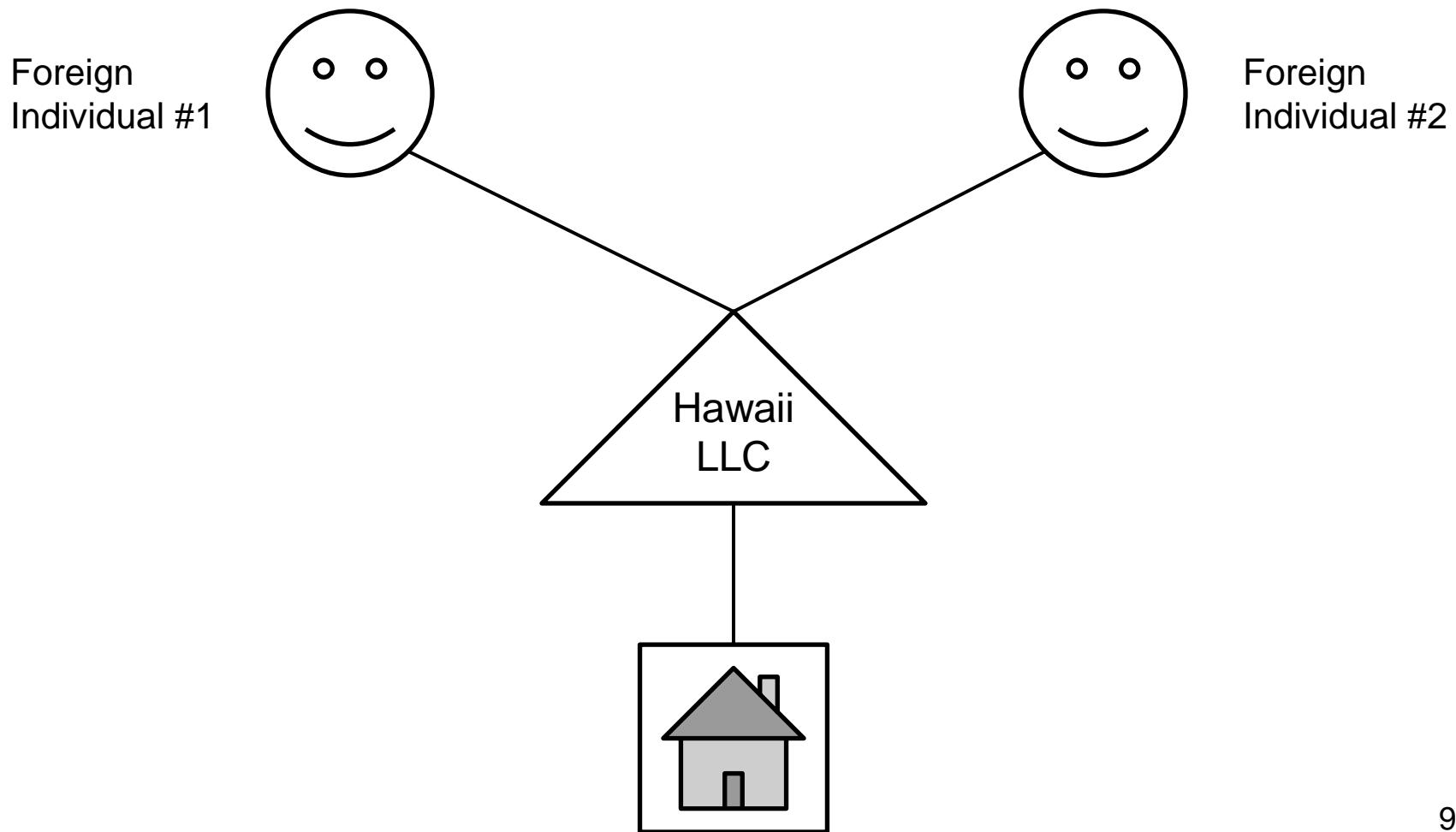


Single-Member Hawaii LLC

Single Member Hawaii LLC

- LLCs are generally disregarded for estate tax, gift tax and income tax purposes
- The foreign member will be treated as owning the property directly (see slide 5)
 - However, LLC will have to file its own GET returns to report any rental income
- An LLC can instead elect to be taxed as a C corporation (see slides 12 and 13)

Multi-Member Hawaii LLC

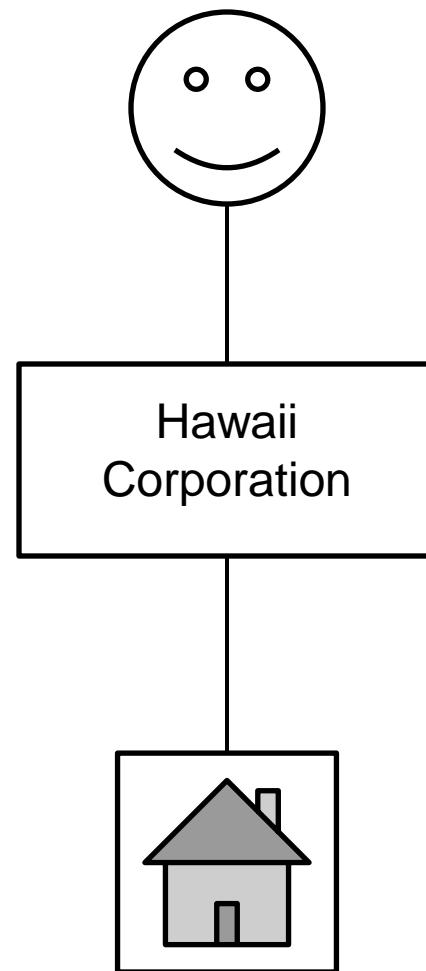


Multi-Member Hawaii LLC

Multi-Member Hawaii LLC (if no C corp election)

- U.S. & Hawaii estate taxes apply to LLC interests
- U.S. gift taxes also likely apply
- LLC and its members must file U.S. and Hawaii tax returns for any rental and sale income
 - Members must make special elections to be taxed on net rental income
 - LLC must withhold on foreign members' income allocations
- FIRPTA and HARPTA will not apply upon sale of the property
 - But FIRPTA will apply if the LLC interests are sold

Hawaii Corporation



Hawaii Corporation

Hawaii Corporation

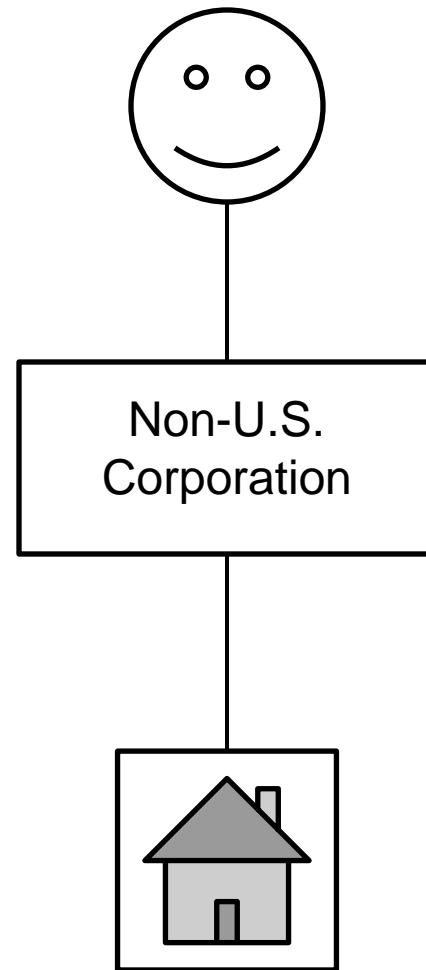
- U.S. and Hawaii estate tax will apply to the corporate stock
- U.S. gift tax will not apply to the corporate stock
- Corporation must file U.S. and Hawaii tax returns to report any rental or sale income
 - Shareholder will generally not have to file U.S. tax returns to report the rental and sale income
- FIRPTA and HARPTA will not apply to a sale of the property
 - But FIRPTA will apply to a sale of the corporate stock

Hawaii Corporation

Hawaii Corporation (cont.)

- Dividends (e.g., distributions of rental income) to the foreign shareholder are subject to a withholding tax of up to 30%
- Liquidation of the corporation triggers corporate income tax in the U.S.
 - Generally no U.S. income tax to the shareholder, but foreign taxes may apply

Non-U.S. Corporation

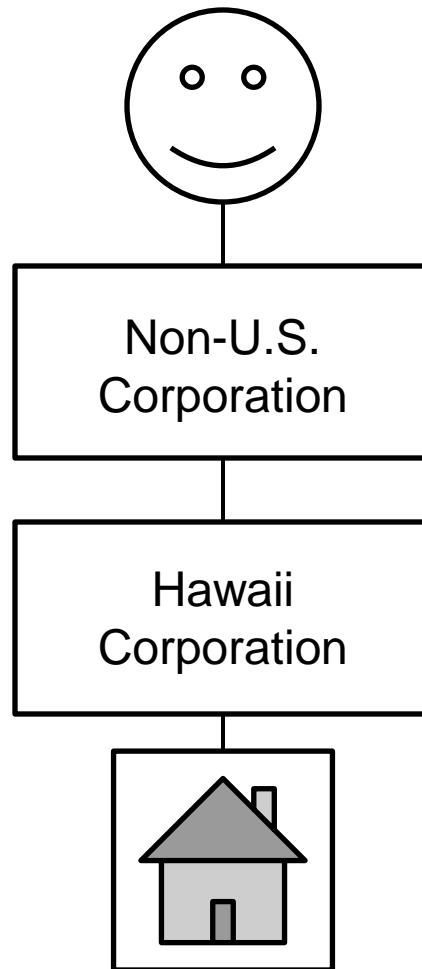


Non-U.S. Corporation

Non-U.S. Corporation

- U.S. and Hawaii estate and gift taxes will not apply to the corporate stock
- Corporation must file U.S. and Hawaii tax returns to any report rental or sale income
 - Election must be made to be taxed on net income
 - Shareholder will not have to file U.S. tax returns
- FIRPTA (and HARPTA) will apply to the sale of the property
- Branch profits tax of up to 30% will apply to deemed dividends of rental income

Hawaii Subsidiary of Non-U.S. Corp



Hawaii Subsidiary of Foreign Corp

Hawaii Subsidiary of Foreign Corporation

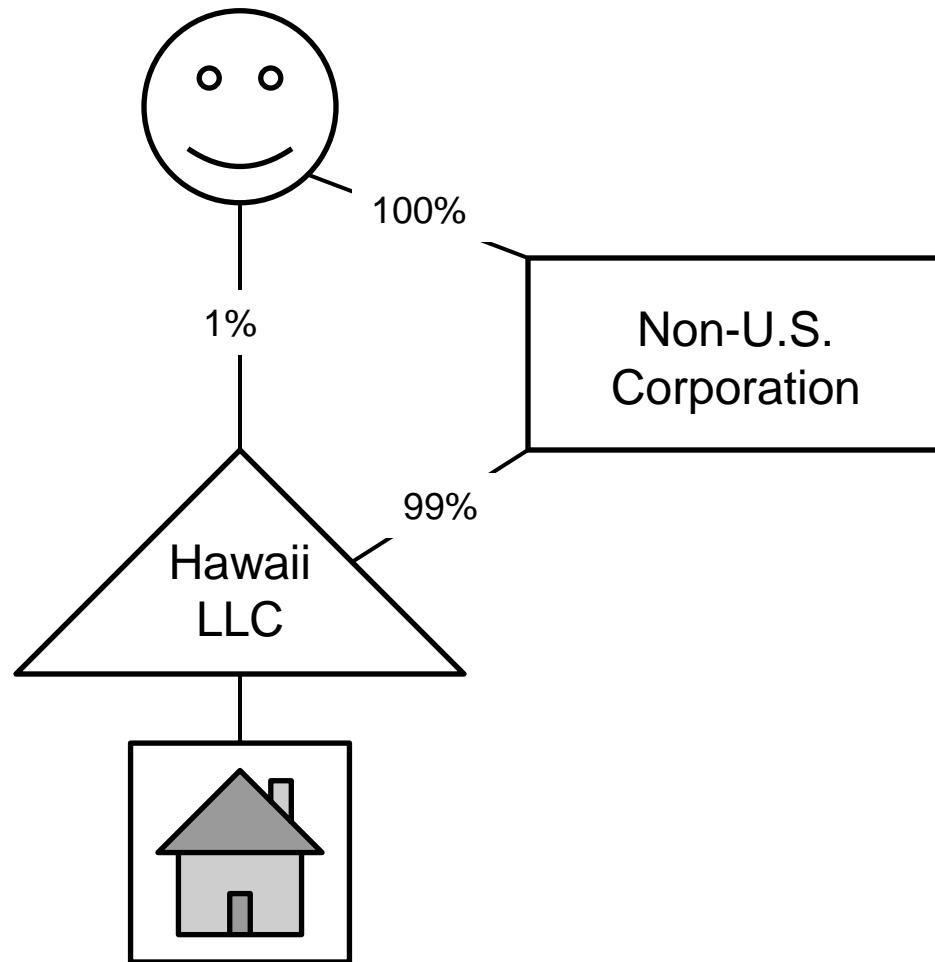
- U.S. and Hawaii estate and gift taxes will not apply to the corporate stock
- The subsidiary must file U.S. and Hawaii tax returns to report any rental or sale income
 - The foreign corporation and the shareholder will not have to file U.S. tax returns
- FIRPTA and HARPTA do not apply to the sale of the property
- Branch profits tax will not apply

Hawaii Subsidiary of Foreign Corp

Hawaii Subsidiary of Foreign Corporation (cont.)

- Dividends (e.g., distributions of rental income) by Hawaii subsidiary to foreign corporation are subject to a withholding tax of up to 30%
 - However, tax treaties often provide a lower rate
- Liquidation of subsidiary may avoid corporate income tax in the U.S.
 - No U.S. income tax on the foreign corporation or shareholder, but foreign taxes may result
- It's best to hold each U.S. property in a separate U.S. subsidiary corporation

LLC with Individual & Corporate Members

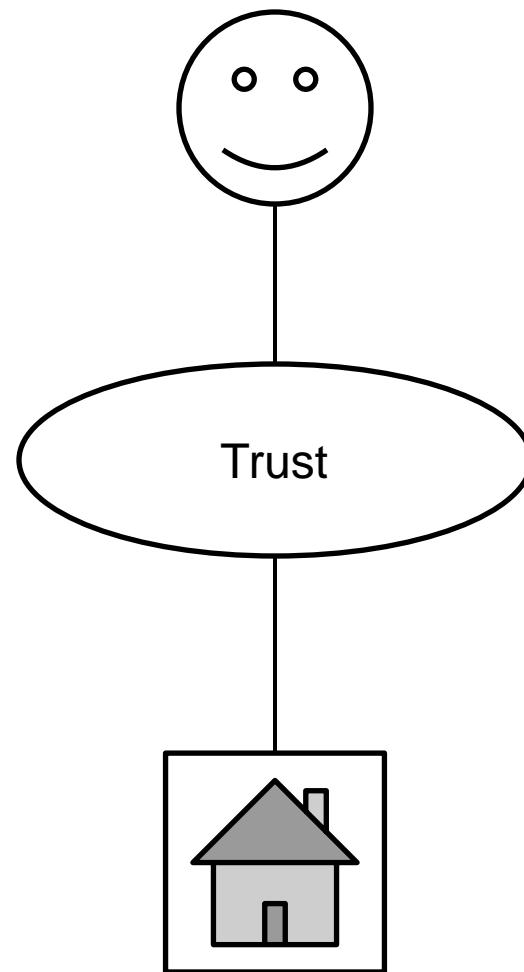


LLC with Individual & Corporate Members

Hawaii LLC with Individual and Corporate Members

- U.S. and Hawaii estate and gift taxes will apply only to the individual's LLC interest
- LLC and its members must file U.S. and Hawaii tax returns to report any rental or sale income
 - Members must make special elections to be taxed on net rental income
 - LLC must withhold on foreign members' income allocations
- FIRPTA and HARPTA will not apply upon sale of the property
 - But FIRPTA will apply if the LLC interests are sold

Trusts



Trusts

Trusts

- Trusts generally involve giving away ownership rights to the property
- To minimize U.S. gift tax issues, the trust should be established before the property is purchased
- Some foreign countries don't recognize trusts
- Foreign trusts are generally subject to FIRPTA, HARPTA and other U.S. and Hawaii withholding and tax rules

Importance of Planning Ahead

Difficulties with Changing the Ownership Structure

- Transferring the property to a relative is a gift subject to U.S. gift tax at up to 40% of the value
- Transferring appreciated property to a non-U.S. corporation triggers U.S. and Hawaii income tax at up to 48% of the gain
 - FIRPTA and HARPTA also apply
- Transferring property to a U.S. corporation or LLC will generally not trigger gain, but the IRS must be notified