

NEIL ABERCROMBIE
GOVERNOR

BRIAN SCHATZ
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1530
FAX NO: (808) 587-1584

FREDERICK D. PABLO
INTERIM DIRECTOR OF TAXATION

RANDOLF L. M. BALDEMOR
DEPUTY DIRECTOR

LATE

SENATE COMMITTEE ON WAYS & MEANS

TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING SB 575 RELATING TO TAXATION

TESTIFIER: **FREDERICK D. PABLO**, INTERIM DIRECTOR OF
TAXATION (OR DESIGNEE)
COMMITTEE: WAM
DATE: FEBRUARY 10, 2011
TIME: 9AM
POSITION: OPPOSED DUE TO POTENTIAL LEGAL
CHALLENGES; CONCERNS WITH REVENUE
LOSS

This measure exempts the first \$50,000 of taxable income received by a business that is incorporated in Hawaii or is a "pass-through" entity that is organized in Hawaii.

The Department of Taxation (Department) **opposes** this bill due to potential legal challenges this bill may present. The Department also raises concerns regarding this bill's unbudgeted revenue loss.

OPPOSED BECAUSE POTENTIALLY UNCONSTITUTIONAL—The Department's primary opposition to this measure relates to its potential unconstitutionality.

The US Constitution is quite clear that out-of-state persons cannot be taxed less favorably than in-state taxpayers.

A US Supreme Court tax case involving the Hawaii taxation of certain drinks containing local okolehao was found unconstitutional. In that case,

Hawaii exempted locally grown okolehao beverages from the liquor tax. The Supreme Court affirmed that the "cardinal rule of Commerce Clause jurisprudence" is that states cannot discriminate in imposing taxes. See *Bacchus Imports v. Dias*, 468 US 263 (1984).

The Department fears this measure would be found likewise unconstitutional because it favors in-state formed businesses vs. out-of-state formed businesses. The Department defers to the Attorney General on the final analysis.

In light of *Bacchus Imports*, the Department suggests this bill be held.

ADD A SUNSET DATE—The Department suggests adding a sunset date for this provision. Adding a sunset date is effective tax policy to ensure that tax incentives that become unnecessary or unwarranted in the future do not remain on the books.

NOT FACTORED INTO BUDGET—The Department must be cognizant of the biennium budget and financial plan. This measure has not been factored into either.

REVENUE IMPACT—This measure will result in a revenue loss of approximately \$205 million per year.



TESTIMONY OF
THE DEPARTMENT OF THE ATTORNEY GENERAL
TWENTY-SIXTH LEGISLATURE, 2011

ON THE FOLLOWING MEASURE:

S.B. NO. 575, RELATING TO TAXATION.

L A T E

BEFORE THE:

SENATE COMMITTEE ON WAYS AND MEANS

DATE: Thursday, February 10, 2011 TIME: 9:00 a.m.

LOCATION: State Capitol, Room 211

TESTIFIER(S): David M. Louie, Attorney General, or
Nathan S.C. Chee, Deputy Attorney General

Chair Ige and Members of the Committee:

The Department of the Attorney General has the following comment on this bill. It may be challenged as violating the Commerce Clause of the United States Constitution.

This bill amends section 235-7, Hawaii Revised Statutes, to add an exemption from state income tax for the first \$50,000 received each taxable year by corporations and pass-through entities that are formed in the State. (Page 5, line 18 through page 7, line 3).

"No State, consistent with the Commerce Clause, may 'impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.'" Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 268 (1984), citing Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318, 329 (1977).

In Bacchus, the United States Supreme Court found that an exemption similar to the exemption proposed in this bill violated the Commerce Clause. At issue in Bacchus was the Hawaii liquor tax, which was originally enacted in 1939 to defray the costs of police and other governmental services. Because the Legislature sought to encourage development of the

Hawaiian liquor industry, it enacted an exemption from the liquor tax for okolehao (a brandy distilled from the root of the ti plant, an indigenous shrub of Hawaii) and for certain fruit wine manufactured in Hawaii. The United States Supreme Court concluded that the exemption violated the Commerce Clause because the exemption had both the purpose and effect of discriminating in favor of local products.

The income tax exemption for local corporations and pass-through entities, as created by this bill, appears to have similar purpose and effect as the exemption that violated the Commerce Clause in Bacchus.

We recommend that this bill be held.