

# **SB 791**

RELATING TO TAXABLE INCOME EXCLUSION.

Provides taxable income exclusion for military on active duty who are serving outside the State pursuant to orders.



**TESTIMONY OF  
THE DEPARTMENT OF THE ATTORNEY GENERAL  
TWENTY-SEVENTH LEGISLATURE, 2013**

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**ON THE FOLLOWING MEASURE:**

**S.B. NO. 791, RELATING TO TAXABLE INCOME EXCLUSION.**

**BEFORE THE:**

**SENATE COMMITTEE ON PUBLIC SAFETY, INTERGOVERNMENTAL AND MILITARY  
AFFAIRS**

**DATE:** Thursday, January 31, 2013

**TIME:** 3:00 p.m.

**LOCATION:** State Capitol, Room 224

**TESTIFIER(S):** David M. Louie, Attorney General, or

Hugh R. Jones, Supervising Deputy, Tax & Charities Division, or

Jodi K. Yi, Deputy Attorney General, Tax & Charities Division

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Chair Espero and Members of the Committee:

The Department of the Attorney General offers the following written comments on this bill.

This bill if adopted into law, could be challenged as violating the Equal Protection and/or Privileges and Immunities Clauses of the United States Constitution or both.

This bill creates an exclusion from gross income, adjusted gross income and taxable income for “[i]ncome from any source received by resident taxpayers who are on active military duty and serving in the United States Army, Navy, Air Force, or Marine Corps outside the State pursuant to military orders.”

A court may conclude that this bill is unconstitutional because it does not expressly articulate a legitimate government interest served by the legislation sufficient to withstand constitutional challenge based on the Equal Protection and/or Privileges and Immunities Clauses of the United States Constitution.

The Equal Protection Clause prohibits discrimination against a nonresident based solely on residency. See, e.g., Williams v. Vermont, 472 U.S. 14 (1985) (use tax credit for sales taxes paid on cars purchased in other states invalidated because it was only available to Vermont residents). The Hawaii Supreme Court has recognized that the Equal Protection Clause applies where a tax operates unequally on persons or property of the same class. In re Swann, 7 Haw. App. 390, 776 P.2d 395 (1989).

Similarly, under the Privileges and Immunities Clause, a state may not impose higher taxes on nonresident individuals than it imposes on its own citizens.<sup>1</sup> However, a discriminatory tax could be sustained if legitimate reasons for the tax exist and the discrimination bears a substantial relation to those reasons. Lunding v. New York Tax Appeals Tribunal, 522 U.S. 287 (1998) (alimony deduction for residents only struck down as violating the Privileges and Immunities Clause).

The residency requirement in this bill arguably violates the Equal Protection and Privileges and/or Immunities Clauses because it expressly favors residents over nonresidents.<sup>2</sup>

To insulate this bill from possible constitutional challenge, we recommend either of two possible remedies: (1) that the bill be amended to provide that the exclusion is available to all taxpayers subject to chapter 235, Hawaii Revised Statutes -- deleting the word "resident" in the bill should remedy this possible constitutional problem; or (2) that a legitimate government purpose substantially related to that purpose be articulated within the preamble of the bill.

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<sup>1</sup> The Privileges and Immunities Clause does not apply to corporations. Toomer v. Witsell, 334 U.S. 385 (1948).

<sup>2</sup> We are aware that a few existing tax statutes have residency requirements. To date, these statutes have not been subject to constitutional challenge.

NEIL ABERCROMBIE  
GOVERNOR

SHAN TSUTSUI  
LT. GOVERNOR



FREDERICK D. PABLO  
DIRECTOR OF TAXATION

JOSHUA WISCH  
DEPUTY DIRECTOR

STATE OF HAWAII  
**DEPARTMENT OF TAXATION**

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To: The Honorable Will Espero, Chair  
and Members of the Senate Committee on Public Safety, Intergovernmental and Military  
Affairs

The Honorable Josh Green, M.D., Chair  
and Members of the Senate Committee on Health

Date: Thursday, January 31, 2013  
Time: 3:00 p.m.  
Place: Conference Room 224, State Capitol

From: Frederick D. Pablo, Director  
Department of Taxation

Re: S.B. 791 Relating to Taxable Income Exclusion

The Department of Taxation (Department) appreciates the intent of S.B. 791 and provides the following information and comments for your consideration.

S.B. 791 provides an income tax exclusion for military members on active duty who are serving outside the State pursuant to orders. The measure is effective upon approval and applies to taxable years beginning after December 31, 2013.

As written, this measure excludes income from any source, not just the pay of the military member. Under these provisions, if a service member had substantial income, such as capital gains, dividends, interest, or rental income, none of it would not be subject to income tax. Also, it should be noted that the exclusion could be applicable to all military members, regardless of their presence within the State.

Thank you for the opportunity to provide comments.

**SB791**

Submitted on: 1/30/2013

Testimony for PSM on Jan 31, 2013 15:00PM in Conference Room 224

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Present at Hearing</b>
Lowell Kalapa	Tax Foundation of Hawaii	Comments Only	No

# TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

**SUBJECT:** INCOME, Exclusion for active duty military resident taxpayers

**BILL NUMBER:** SB 791

**INTRODUCED BY:** Slom and 2 Democrats

**BRIEF SUMMARY:** Amends HRS section 235-7(a) to exclude from state income taxation, income received by resident taxpayers who are on active military duty and serving in the United States Army, Navy, Air Force, or Marine Corps outside the state pursuant to military orders.

**EFFECTIVE DATE:** Tax years beginning after December 31, 2013

**STAFF COMMENTS:** The proposed measure would exclude all income received by resident taxpayers on active military duty while serving out of state from state income taxation. It should be remembered that not only would the exclusion exclude what they are paid for duty but also interest, dividend income, etc., from state income taxation. As drafted, rental income or capital gains from the sale of property or stocks would be exempt under this proposal. So while the federal income taxes would be due on such income, they would escape the state income tax.

Active military personnel already benefit from having access to military stores where no general excise or certain specific excise taxes are imposed. This benefit would otherwise have been tax revenue to the state and is a substantial subsidy by Hawaii taxpayers as well as all federal taxpayers who subsidize the transportation and warehousing of the goods.

If the intent of this measure is to subsidize or supplement the compensation of a Hawaii resident who is on active duty, then the subsidy should come from all taxpayers across the country for whom the active duty personnel are performing services, not just from Hawaii taxpayers.

If this measure is being proposed in sympathy for members of the armed forces who have been deployed, lawmakers should know that Hawaii's conformity with Section 112 of the Internal Revenue Code already excludes active duty pay earned in any month served in those combat zones. Thus, for those who are serving in a combat zone, pay received for that service is not taxable under the state income tax law.

Digested 1/30/13



January 30, 2013

**LATE TESTIMONY IN SUPPORT OF SENATE BILL 791  
RELATING TO TAXABLE INCOME EXCLUSION.**

**SENATE COMMITTEE ON PUBLIC SAFETY AND MILITARY  
HEARING ON THURSDAY, JANUARY 31<sup>ST</sup> AT 3:00 PM, IN CONFERENCE  
ROOM 224**

Aloha Chair Espero: The Oahu Veterans Council is delegates are honored to serve at the pleasure of our veterans and their families. On January 29<sup>th</sup>, our committee reviewed and voted unanimously to support Senate Bill 791

We are extremely grateful for your efforts to provide a taxable income exclusion for military personnel on active duty who are serving outside the State pursuant to orders.

Providing this preference in state law is much appreciated by family of our deployed military personnel. They ask for no more compassion than we would expect for ourselves.

The Oahu Veterans Council respectfully urges your committee to consider passing Senate Bill 791 as written. Mahalo, for allowing us to testify, regarding this extremely important issue.

*Dennis Egge*

Dennis Egge; Chairman, Legislative Committee



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**SB791**

Submitted on: 1/28/2013

Testimony for PSM on Jan 31, 2013 15:00PM in Conference Room 224

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Present at Hearing</b>
Daniel Alvarez	Individual	Support	No



**SB791**

Submitted on: 1/30/2013

Testimony for PSM on Jan 31, 2013 15:00PM in Conference Room 224

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Present at Hearing</b>
Nathan Stickel	Individual	Support	No

**SB791**

Submitted on: 1/30/2013

Testimony for PSM on Jan 31, 2013 15:00PM in Conference Room 224

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Present at Hearing</b>
Phil Ramil	Individual	Support	No

Comments: As a former military serviceman, I support this bill.