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RE: **Military Spouses Residency Relief Act (“MSRRA”)**

This Tax Information Release (“TIR”) provides guidance on the effects of the Servicemembers Civil Relief Act (“SCRA”) (P.L. 108-189; December 19, 2003) as amended by the MSRRA (P.L. 111-97; November 11, 2009) for Hawaii income tax and withholding purposes. Effective for taxable years that begin on or after January 1, 2009, a qualifying nonresident spouse of a servicemember may source his or her income from services performed in Hawaii to their state of residence. This TIR discusses the qualifying conditions, the types of incomes that are exempt or taxable, Hawaii income tax filing requirements (including how to file for a refund for Hawaii income tax withheld), the employer’s duties as it pertains to Hawaii income tax withholding, and other information pertinent to the application of the SCRA to Hawaii income tax.

I. **BACKGROUND**

For state income tax purposes, the SCRA governs the determination of residence or domicile for servicemembers and their spouses. The SCRA provides that a servicemember will not lose (or acquire) a residence or domicile by being present in (or absent from) a tax jurisdiction in the United States solely in compliance with the servicemember’s military or naval orders. The MSRRA amended the SCRA to add a similar provision so that a servicemember’s spouse will not lose (or acquire) a residence or domicile by being present in (or absent from) a tax jurisdiction in the United States solely to be with the servicemember in compliance with the servicemember’s military or naval orders.

II. **RESIDENTS AND NONRESIDENTS**

Domicile is the place of an individual's true, fixed, permanent home and the principal establishment to which the individual has the intention of returning whenever the individual is absent (Hawaii Administrative Rules (“HAR”) §18-235-1.03).

Resident. A resident is every individual domiciled in Hawaii, and every other individual whether domiciled in Hawaii or not, who resides in Hawaii for other than a temporary or transitory purpose (Hawaii Revised Statutes (“HRS”) §235-1). A resident is subject to Hawaii income tax on income from all sources, both inside and outside of Hawaii. Pursuant to HRS

§235-55, a resident with out-of-state income that is taxed by another state or foreign country and also by Hawaii may claim a credit for income taxes paid to the other state or foreign country if certain conditions are met. A resident who is required to file a Hawaii individual income tax return must file Form N-11, *Individual Resident Income Tax Return*, or Form N-13, *Individual Resident Income Tax Return (Short Form)*, whichever is applicable.

Resident Servicemember. A resident servicemember retains his or her Hawaii domicile for Hawaii income tax purposes regardless of where the resident is stationed under military or naval orders and will continue to be a resident unless he or she establishes domicile elsewhere. A resident servicemember is subject to Hawaii income tax on income from all sources, both inside and outside of Hawaii, and must file a Hawaii resident individual income tax return on Form N-11 or Form N-13 (Short Form), whichever is applicable.

Resident Spouse of a Servicemember. A resident spouse of a servicemember retains his or her Hawaii domicile for Hawaii income tax purposes regardless of where the resident spouse moves to be with the servicemember under the servicemember's military or naval orders, and will continue to be a resident unless he or she establishes domicile elsewhere. A resident spouse of a servicemember is subject to Hawaii income tax on his or her income from all sources both inside and outside of Hawaii, and must file a Hawaii resident individual income tax return on Form N-11 or Form N-13 (Short Form), whichever is applicable. Under the SCRA, a resident spouse of a resident servicemember is also subject to Hawaii income tax on his or her income from services performed in another state or country if the spouse is present in that state or country solely to be with the servicemember serving in compliance with military or naval orders.

Nonresident. A nonresident is every individual other than a resident (HRS §235-1). Generally, a nonresident is subject to Hawaii income tax on all Hawaii-sourced income such as rental income derived from property in Hawaii, personal services performed, trade, or business carried on, and any and every other source in the State (HRS §235-4(b)). A nonresident who is required to file a Hawaii individual income tax return must file Form N-15, *Individual Income Tax Return for Nonresidents and Part-Year Residents*. A nonresident with no Hawaii-source income (e.g., a nonresident servicemember with only military or naval service income), is not required to file a Hawaii income tax return.

Nonresident Servicemember. A nonresident servicemember stationed in Hawaii in compliance with military or naval orders is not a Hawaii resident and will be treated as a nonresident for Hawaii income tax purposes unless the servicemember establishes residence or domicile in Hawaii. A nonresident servicemember is subject to Hawaii income tax on his or her Hawaii-sourced income such as Hawaii rental income and non-military source wages, salaries, tips, and commissions. The nonresident servicemember's military or naval service income is not Hawaii-sourced income; therefore, it is not subject to Hawaii income tax. A nonresident servicemember with Hawaii-sourced income is required to file Form N-15. A nonresident servicemember with no Hawaii-sourced income is not required to file a Hawaii income tax return.

Nonresident Spouse of a Servicemember. A nonresident spouse of a servicemember who is present in Hawaii solely to be with the servicemember serving in compliance with military or naval orders is not a Hawaii resident and will be treated as a nonresident unless the spouse establishes residence or domicile in Hawaii. A nonresident spouse of a servicemember is subject to Hawaii income tax on his or her Hawaii-sourced income. However, if the nonresident spouse satisfies the conditions prescribed under the SCRA (discussed in Part III of this TIR), then the nonresident spouse's income from services performed in Hawaii is not considered Hawaii-sourced income and is not subject to Hawaii income tax or Hawaii withholding. If the nonresident spouse does not satisfy the conditions prescribed under the SCRA, then the nonresident spouse's income from services performed in Hawaii is Hawaii-sourced income and is subject to Hawaii income tax and Hawaii withholding. A nonresident spouse with Hawaii-sourced income is required to file Form N-15. A nonresident spouse with no Hawaii-sourced income is not required to file a Hawaii income tax return.

Filing Status Options. The filing status options for filing a Hawaii income tax return are single, married filing jointly, married filing separately, head of household (with qualifying person), and qualifying widow(er) with dependent child. Under HRS §235-93, if a husband and wife are entitled to file a joint federal income tax return for the taxable year, then they may elect to file jointly or separately for Hawaii income tax purposes. A nonresident married to a resident may choose to file a joint return with the resident spouse on Form N-11 or N-13; however, the nonresident will then be taxed on all income from all sources. If a husband and wife file a joint Hawaii income tax return and later decide to file separately, both the husband and wife must file amended returns on or before the due date of the original return (April 20). Changing your filing status from married filing jointly to married filing separately after the original due date is not permitted (HAR §18-235-93(b)).

For more information, please refer to:

1. TIR No. 97-1, *"Determination of Residence Status"*;
2. TIR No. 90-3, *"Income Taxation and Eligibility for Credits of an Individual Taxpayer Whose Status Changes from Resident to Nonresident or from Nonresident to Resident"*; and
3. TIR No. 90-10, *"Clarification of Taxation and the Eligibility for Personal Exemptions and Credits of Residents and Nonresidents in the Military and Spouses and Dependents of Persons in the Military."*

III. CONDITIONS TO QUALIFY FOR A HAWAII INCOME TAX EXEMPTION UNDER THE SCRA

Income received by the servicemember's civilian spouse for services performed by the servicemember's spouse in Hawaii is not considered Hawaii-sourced income and therefore, not subject to Hawaii income tax if **all** of the following conditions are met:

1. The servicemember (as defined in 10 U.S.C. §101(a)(5)) is present in Hawaii solely in compliance with military or naval orders;
2. The spouse is in Hawaii solely to be with the servicemember; and
3. The spouse and servicemember are domiciled in the same state and that state is not Hawaii.

(Note: The exemption only applies to the servicemember's spouse. Any non-military source income earned in Hawaii by the servicemember is subject to Hawaii income tax.)

IV. MILITARY ASSIGNMENTS

Temporary Duty (“TDY”). A servicemember’s TDY assignment (e.g., deployment to a combat zone), will not affect his or her spouse who previously qualified for a Hawaii income tax exemption under the SCRA as long as the spouse remains in Hawaii and the servicemember’s permanent duty station continues to be in Hawaii. If the servicemember’s permanent duty station is not in Hawaii and the spouse remains in Hawaii, then the spouse will no longer qualify.

Permanent Change of Station (“PCS”). If a servicemember receives a PCS outside of Hawaii and the spouse remains in Hawaii, then the servicemember’s spouse who previously qualified for a Hawaii income tax exemption under the SCRA will no longer qualify.

V. INCOME THAT IS EXEMPT FROM HAWAII INCOME TAX UNDER THE SCRA

Provided that the requirements of the SCRA (described in Part III above) are met, a servicemember’s spouse is exempt from Hawaii income tax on his or her income received from:

- Wages, salaries, tips, commissions, and other compensation for services performed in Hawaii as an employee;

Example 1: A servicemember’s spouse earns a salary as a teacher at an elementary school in Hawaii. Provided that the conditions under the SCRA are met, the salary is exempt from Hawaii income tax.

Example 2: A servicemember’s spouse earns wages and tips as a bartender at a restaurant in Hawaii. Provided that the conditions under the SCRA are met, the wages and tips are exempt from Hawaii income tax.

- Unemployment insurance benefits received to replace wages, salaries, and other compensation exempt under the SCRA;

Example 3: Assume the facts as example 1, except the servicemember’s spouse becomes unemployed and collects unemployment insurance benefits. Provided that the conditions under the SCRA are met, the unemployment benefits are treated as replacement income and exempt from Hawaii income tax.

- Temporary Disability Insurance (“TDI”) benefits received to replace wages, salaries, and other compensation exempt under the SCRA;

Example 4: Assume the facts as example 1, except the servicemember’s spouse sustains a nonwork-related injury and receives TDI benefits. Provided that the conditions under the SCRA are met, the TDI benefits are treated as replacement income and exempt from Hawaii income tax.

- Income from his or her sole-proprietorship or single member limited liability company (“LLC”) if the income is directly and solely attributable to services performed in Hawaii by the servicemember’s spouse. The LLC must be a disregarded entity¹ for federal and Hawaii income tax purposes. The exemption does not apply to income from any other pass-through entity such as an LLC with two or more members, a partnership, or an S-Corporation (including an S-Corporation with a sole shareholder).

Example 5: A servicemember’s spouse is a self-employed real estate agent who operates as a sole proprietor earning commissions from selling real estate in Hawaii. Provided that the conditions under the SCRA are met, the commissions are exempt from Hawaii income tax. (*Note: The income is subject to the general excise tax.*)

VI. TAXABLE INCOME

The SCRA specifically exempts from Hawaii income tax the “income for services performed by the spouse of a servicemember” who meets certain conditions. The incomes listed below are not attributable to services performed; therefore, these types of income are subject to Hawaii income tax:

- Rental income from real or tangible property located in Hawaii²;
- Capital gain from the sale of real property located in Hawaii³; and/or
- Royalty income attributable to Hawaii.⁴

Example 6: A servicemember’s spouse is a self-employed real estate agent who operates as a sole proprietor earning commissions from selling real estate in Hawaii. In addition, the servicemember’s spouse receives rental income by renting out an apartment in Hawaii. Provided that the conditions under the SCRA are met, the commissions are exempt from Hawaii income tax, but the rental income is Hawaii-

¹ A single member limited liability company is classified for federal income tax purposes as a disregarded entity under the default rules unless it files federal Form 8832. Notwithstanding any Hawaii income tax law to the contrary, the entity classification elected for federal income tax purposes will be the same for Hawaii income tax purposes.

² HRS §235-25.

³ HRS §235-26.

⁴ HRS §§235-26 and 235-28.

sourced income and subject to Hawaii income tax. *(Note: Both the commissions and rental income are subject to the general excise tax.)*

VII. EXCLUSIONS

The Hawaii income tax exemption provided under the SCRA does not apply in any of the following situations where the servicemember's spouse:

- (A) Is a resident or domiciliary of Hawaii;

Example 7: A servicemember is domiciled in State A and stationed in Hawaii. While in Hawaii, the servicemember meets and marries a person who is domiciled in Hawaii. The servicemember's spouse is not exempt from Hawaii income tax under the SCRA.

- (B) Is a resident or domiciliary of a state different from that of the servicemember. The spouse cannot simply elect, adopt, assume, or inherit the servicemember's domicile. The spouse must have physically lived in and established his or her domicile, and maintained it as such by forming and maintaining the necessary contacts (e.g., registering to vote, maintaining property, etc.). An individual may not recapture an abandoned domicile unless he or she physically returns to live in the previously abandoned domicile and re-establishes his or her residence or domicile.

Example 8: A servicemember is domiciled in State A and stationed in State B. While in State B, the servicemember meets and marries a person who is domiciled in State B. The servicemember and spouse move to the servicemember's new permanent duty station in Hawaii and the spouse earns wages by working for a company in Hawaii. The spouse's wages are subject to Hawaii income tax and withholding because the spouse does not have the same domicile as the servicemember.

- (C) Is also a servicemember stationed in Hawaii and has non-military Hawaii-source income;

Example 9: A married couple, both nonresident servicemembers, is stationed in Hawaii in compliance with their military orders. One of the servicemembers earns non-military wages and tips by working a second job for a company in Hawaii. The non-military wages and tips are subject to Hawaii income tax and withholding.

- (D) Legally separates or divorces the servicemember. The Hawaii income tax exemption ceases when the spouse maintains a separate physical residence from the servicemember or when the divorce decree is entered into, whichever occurs first;

- (E) Maintains a physical separation;

Example 10: The servicemember has been assigned to a new permanent duty station in another state. The spouse is allowed to join the servicemember, but chooses not to and remains in Hawaii. The spouse no longer qualifies for a Hawaii income tax exemption.

Example 11: Same facts as example 10 except the spouse is not allowed to join the servicemember and the spouse remains in Hawaii. The spouse no longer qualifies for a Hawaii income tax exemption.

- (F) Takes action(s) that establish residence or domicile in Hawaii. For example, remaining in Hawaii when the servicemember permanently moves outside of Hawaii.

VIII. WITHHOLDING

A nonresident spouse whose salary, wages, tips, or other compensation is exempt from Hawaii income tax under the SCRA may claim an exemption from Hawaii income tax withholding by filing the following forms with his or her employer:

1. Form HW-4, *Employee's Withholding Allowance and Status Certificate**;
2. Form HW-6, *Employee's Statement to Employer Concerning Nonresidence in the State of Hawaii**;
**(Note: The most current version of the form must be used. Tax forms are available online at www.hawaii.gov/tax).*
3. A copy of the servicemember's military or naval orders assigning the servicemember to a post of duty in Hawaii;
4. A copy of the servicemember's Leave and Earning Statement ("LES")⁵ indicating that the servicemember's legal residence for purposes of withholding state income taxes from military pay is a state other than Hawaii; and
5. A valid, unexpired military spouse identification card⁶ that identifies the card-holder as a spouse and not merely a dependent;

The employer must verify that its employee is not subject to Hawaii income tax withholding and retain the documentation listed above as proof of the exemption. The employer must reject Form HW-4 and withhold Hawaii income tax if the employer has knowledge that the certificate is not valid because the employee does not meet the conditions to be exempt from Hawaii income tax withholding.

Change in Status. If the employee no longer qualifies for a Hawaii income tax exemption (e.g., the spouse divorces the servicemember) under the SCRA, then the employer is required to withhold Hawaii income taxes from the employee's wages (HRS§235-61). The employee must notify his or her employer and file a new Form HW-4 with his or her employer within 10 days from the date that he or she no longer qualifies for an exemption.

⁵ Generally, the servicemember may access this information online from the Defense Finance and Accounting Service ("DFAS") website.

⁶ Copying a military identification card to obtain tax benefits is authorized under Department of Defense Instruction 1000.13, paragraph 6.1.7.

IX. HOW TO FILE FOR A REFUND OF HAWAII INCOME TAX WITHHELD

If a nonresident spouse had Hawaii income tax withheld on his or her salary, wages, or other compensation that is now exempt under the SCRA, the taxpayer must file Form N-15, *Individual Income Tax Return for Nonresidents and Part-Year Residents*, to claim a refund. Write "MSRRA" at the top of Form N-15, and attach a copy of the following documents:

1. Form W-2 showing the amount of Hawaii income tax withheld;
2. The servicemember's military or naval orders assigning the servicemember to a post of duty in Hawaii;
3. A valid, unexpired military spouse identification card⁷ that identifies the card-holder as a spouse and not merely a dependent; and
4. The servicemember's Leave and Earnings Statement indicating that the servicemember's legal residence for purposes of withholding state income taxes from military pay is a state other than Hawaii.

The nonresident spouse's income that is exempt from Hawaii income tax under the SCRA should only be reported in Column A. Do not report any income that is exempt under the SCRA in Column B (Hawaii income). If the nonresident spouse is filing an amended Form N-15, fill-in the "Amended Return" box at the top of Form N-15 to indicate that the return is an amended return. The nonresident should also file a resident income tax return with his or her state of domicile to the extent required by the state of domicile.

X. PROOF OF EXEMPTION

The spouse of a servicemember who is claiming an exemption from Hawaii income tax under the SCRA may be required by the Department of Taxation ("Department") to provide proof that he or she qualifies for the exemption. The determination of a person's domicile must be determined by all of the factual circumstances. Elements that may be examined include, but are not limited to, permanent change of station documentation, prior state filing history and tax returns, voter registration, place of marriage, place of business interests, profession, or employment; declarations regarding residence made to public authorities, friends, relatives or employers, or in documents such as deeds, leases, mortgages, contracts, and insurance policies. See TIR No. 97-1 for more information. The absence of satisfactory evidence to support an exemption claimed under the SCRA will give rise to the conclusion that the taxpayer does not qualify for the exemption.

XI. GENERAL EXCISE TAX, USE TAX, & OTHER TAXES

The tax exemption provided under the SCRA is not applicable to the General Excise Tax, Use Tax, and any other taxes administered by the Department. There are no exemptions under the SCRA for these tax types. A nonresident spouse who qualifies for a Hawaii income tax

⁷ Copying a military identification card to obtain tax benefits is authorized under Department of Defense Instruction 1000.13, paragraph 6.1.7.

exemption under the SCRA continues to be subject to all other taxes administered by the Department as applicable.

XII. ADDITIONAL INFORMATION

Additional information about Hawaii's taxes, including tax forms and instructions, is available on the Department's website at www.hawaii.gov/tax. You may also contact the Taxpayer Services Branch on Oahu at 808-587-4242 (toll-free from the neighbor islands and continental U.S. at 1-800-222-3229), or via e-mail at Taxpayer_Services@hawaii.gov.

A handwritten signature in black ink, appearing to read "Kurt Kawafuchi".

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