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Congress Overrides State “Source Tax” Rules

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6.0—Military Service and Tax Laws

In the 1980s, California and other states attempted to tax the retirement income of retirees who had moved to other states after retirement. California claimed that if Joe Smith spent his working life in California and thereby earned a pension, California could tax Joe’s receipt of pension benefits in retirement, even after Joe moved to Nevada (which has no state income tax) or some other state.

California tried to apply this “source tax” principle to military retirement—if Joe was domiciled in California (regardless of where he was stationed) during most of his military career, California claimed the right to tax Joe’s military retirement. California also applied the principle to federal, state, or local government retirement programs and private sector pensions. If you lived in California for your career, you owed California state income tax on your retirement benefits, even after moving to another state.

California’s source tax rule at least arguably violated the right of interstate travel recognized by the Supreme Court in *United States v. Guest*, 383 U.S. 745, 757 (1966). The issue of the constitutionality of the source tax was effectively mooted by Congress in 1995, when Congress enacted section 114 of title 4, United States Code. “No State may impose an income tax on any retirement income of an individual who is not a resident or domiciliary of such State (as determined under the laws of such State).” 4 U.S.C. 114(a). This provision is clearly constitutional and binding on California and other states.

Although Congress outlawed the odious source tax 15 years ago, some states are still trying to weasel out of their federal obligations. I have heard from a retired Coast Guard Chief Petty Officer who lives in New Hampshire, which has no state income tax. He is a seasonal employee of the United States Department of Interior (Park Service). He spends three months of each year (the summer season) working at a national park in Wisconsin, and he pays Wisconsin state income tax on his Park Service seasonal income. He does not object to paying Wisconsin state income tax on his Park Service income, but he strenuously objects to Wisconsin charging him state income tax on his Coast Guard retired pay.

I think that Wisconsin’s practice clearly violates 4 U.S.C. 114. This retired Chief is not a resident or domiciliary of Wisconsin when he comes there for a three-month job. He remains domiciled in New Hampshire while away from the state for a temporary purpose of this kind. Wisconsin has no right to tax his Coast Guard retired pay, but the Park Service withheld this money from his summer pay and remitted it to Wisconsin, at Wisconsin’s request. Wisconsin won’t give up the money without a fight. This retired Chief needs a Wisconsin lawyer to represent him on a *pro bono* basis. Any volunteers? Please call me at 800-809-9448, extension 730, or e-mail me at swright@roa.org.