TESTIMONY OF
THE DEPARTMENT OF THE ATTORNEY GENERAL
KA ʻOIHANA O KA LOIO KUHINA
THIRTY-THIRD LEGISLATURE, 2026

ON THE FOLLOWING MEASURE:
S.B. NO. 3313, RELATING TO INTERISLAND AIR SERVICE.

BEFORE THE:
SENATE COMMITTEE ON TRANSPORTATION

DATE: Thursday, February 12, 2026 **TIME:** 3:01 p.m.

LOCATION: State Capitol, Room 229

TESTIFIER(S): Anne E. Lopez, Attorney General, or
Michael D. Dunford, Deputy Attorney General

Chair Inouye and Members of the Committee:

The Department of the Attorney General has significant concerns about this bill, and provides the following comments.

This bill establishes a Hawaii interisland air service stability and transportation program ("the Program"), to be administered by the Department of Taxation. The Program would support interisland air service and stability by offering refundable tax credits to participating carriers in exchange for a combination of public-benefit commitments and an equity stake in the carrier. Participation in the program would be voluntary, with carriers opting in by applying to participate, and the Department of Taxation determining whether carriers meet the requirements specified in the bill. The Program sets standards, requires applications, mandates reporting and compliance, and authorizes investigation and penalties for misrepresentation or noncompliance. It would take effect July 1, 2026, and sunset June 30, 2036.

Under the Program, participating interisland air service operators would, as a condition of participation in the Program, issue equity interests to the State. They would receive, in turn, refundable and tranferrable tax credits of up to 150 percent of qualified interisland expenditures. Tax credits made available by this bill include credits of not more than fifteen percent for specified capital investments; not more than ten percent for improvements to essential interisland air cargo services; not more than ten percent for wages paid to State residents employed in specified positions; not more than fifteen

percent for improvements to specified performance benchmarks; not more than ten percent for neighbor island hub investments; not more than ten percent for specified apprenticeship and training program expenditures; not more than five percent for rural or community access commitments; not more than five percent for medical transport coordination; and not more than ten percent for agricultural freight improvements.

There are two potential issues with the bill. First, the Program itself is subject to challenge on the grounds that it is preempted under 49 U.S.C. § 41713, because the law is related to the prices, routes, or services of an air carrier that may provide air transportation. Second, a provision within the tax credit portion of the bill that provides credits for the wages of local residents may be subject to challenge under the Commerce Clause and Privileges and Immunities Clause of the United States Constitution.

The Airline Deregulation Act, codified at 49 U.S.C. § 41713, states that a State "may not enact or enforce a law, regulation, or other provision having the force and effect of law related to a price, route, or service of an air carrier that may provide air transportation." 49 U.S.C. § 41713(b)(1). State laws are "related to" a price, route, or service if they have either "a connection with, or reference to" airline prices, routes, or services. *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992). A law "may relate to a [price, route, or service], and thereby be preempted, even if the law is not specifically designed to affect such [price, route, or service]." *Id*. at 386.

Here, the Program conditions participation and benefits on voluntary public-benefit commitments by the carrier to provide or maintain specified interisland services. Even though participation is voluntary, the Program can be challenged as "related to" routes and services within the meaning of 49 U.S.C. § 41713. The Program acts immediately and exclusively upon interisland air carriers and depends on the existence of interisland routes and services for its operation. As such, this likely constitutes a "reference to" airline services, because the Program has no function apart from the existence of those services. *See Air Transp. Ass'n of America v. City & County of San Francisco,* 266 F.3d 1064, 1071 (9th Cir. 2001). Although the connection with air services is a result of economic influence brought about through tax benefits rather than

a direct regulatory compulsion, the Program effectively binds participating carriers to certain operational choices, such as maintaining uneconomic routes or specified frequencies to preserve eligibility. This kind of economic pressure can be deemed a "forbidden significant effect" on routes and services that falls within the preemptive scope of the Airline Deregulation Act. Finally, courts generally do not exempt "voluntary" programs from preemption when they operate as targeted economic inducements directed at the services that Congress chose to deregulate.

It can be argued that the Program should avoid federal preemption because its voluntary incentive framework does not compel any air carrier to alter its routes, prices, or services absent the air carrier's decision to seek State benefits. Under this view, air carriers may operate without regard to Program conditions, with the statute simply defining the terms on which the State will extend financial incentives. However, *Morales* and related cases focus on the nature and effect of the state law, not solely on whether air carriers have the option to avoid it. Where a state law is expressly designed to stabilize and influence interisland air services and does so by tying financial incentives to specific service commitments, a court could conclude that the Program's relationship to airline services is more than "tenuous, remote, or peripheral," and therefore preempted even if participation is voluntary. See *Morales*, 504 U.S. at 383, 390. The fact that the Program operates through tax credits and equity, rather than direct route mandates, likely does not insulate it from federal preemption if its practical effect is to shape the interisland service market Congress chose to deregulate.

These preemption concerns are also likely to affect the equity participation and tax credit components of the bill, in addition to the public benefit requirements discussed above. The equity participation requirement risks binding participating air carriers to particular ownership and capital structures that may alter how they compete and operate. While some courts have upheld certain airport-proprietor conditions, the more the State uses equity and governance conditions as levers to shape route and service decisions, the closer the requirement comes to regulation that has more than a "tenuous" connection to prices, routes, or services. See *Southwest Airlines Co. v. City of San Antonio*, 752 F. Supp. 3d 635, 645 (W.D. Tex. 2024). Similarly, because the tax

credit provisions are largely conditioned on specifically identified requirements that are linked to prices, routes, or services, these, too, are potentially subject to preemption.

For these reasons, the Program, as drafted, carries the risk of being found preempted as a state law "related to" interisland air carrier services.

The provisions of this bill that provide tax credits for expenditures for wages paid only to local residents (page 20, lines 5-8) may be subject to challenge under the Commerce Clause of the United States Constitution. The Commerce Clause provides Congress with the power to "regulate Commerce . . . among the several States." U.S. Const. art I, § 8. cl. 3. "Though phrased as a grant of regulatory power to Congress, the clause has long been understood to have a 'negative' aspect that denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles in commerce." *Oregon Waste Systems, Inc. v. Dep't of Envtl. Quality*, 511 U.S. 93, 98 (1994). This restriction is often referred to as the "dormant" Commerce Clause doctrine. In broad terms, this doctrine prevents states from discriminating in favor of in-state industries at the expense of out-of-state businesses. For example, providing tax benefits to alcoholic beverages produced only in Hawai‘i was found to violate the Commerce Clause because it discriminated in favor of local products at the expense of interstate commerce. *See Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984). Discrimination that takes place through a tax credit, rather than directly through the imposition of a tax, does not change the analysis, because the "economic substance" of the denial of the credit is the same as that of the imposition of a higher tax rate. *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 405 (1984).

Provisions of this bill provide tax credits for wages paid to local residents, but not to non-local residents. This has the effect of encouraging and incentivizing the use of local labor over the use of non-local labor, and may be seen by the courts as having the effect of benefitting "in-state economic interests by burdening out of state competitors." *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 273-74 (1988). The local hire provisions of this bill are therefore potentially vulnerable to challenge under the Commerce Clause.

The local hire provisions may also be subject to challenge under the Privileges and Immunities Clause of the Constitution, which provides that "the citizens of each state shall be entitled to all privileges and immunities of citizens in the several states." U.S. Const. art IV, § 2. Employment "is one of the most fundamental of those privileges protected by the Clause." *United Bldg. & Const. Trades Council of Camden Cnty. & Vicinity v. Mayor & Council of City of Camden*, 465 U.S. 208, 219 (1984). The Privileges and Immunities Clause prohibits discrimination against citizens of another state where the reason for the discrimination is their status as citizens of another state. *See Hicklin v. Orbeck*, 437 U.S. 518, 525 (1978).

Although the provisions of this bill do not expressly require the hiring of local employees, they serve a similar purpose by providing a large economic incentive if productions hire local employees. This may be viewed by the courts as a form of discrimination against citizens of other states, based on their status as citizens of other states. As a result, the local hire provisions may also be vulnerable to a challenge brought under the Privileges and Immunities Clause.

It may, however, be possible to reduce this legal risk by amending this provision. For example, replacing "residents of the State employed in interisland operations" (page 20, line 5-6) with "workers employed full-time in interisland operations," would address the concerns while likely having similar practical effects. Another possible course of action would be to drop this provision, and provide greater credits to other services. Yet another potential approach would be to replace the credit for the wages of local residents with one for the wages of non-flying employees engaged in interisland operations.

Thank you for giving us the opportunity to express our concerns.

JOSH GREEN M.D.
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TESTIMONY OF GARY S. SUGANUMA, DIRECTOR OF TAXATION

TESTIMONY ON THE FOLLOWING MEASURE:
S.B. No. 3313, Relating to Interisland Air Service

BEFORE THE:
Senate Committee on Transportation

DATE: Thursday, February 12, 2026
TIME: 3:01 p.m.
LOCATION: State Capitol, Room 229

Chair Inouye, Vice-Chair Elefante, and Members of the Committee:

The Department of Taxation (DOTAX) offers the following comments regarding S.B. 3313 for your consideration.

Section 2 of S.B. 3313 amends Hawaii Revised Statutes, (HRS), by adding a new chapter titled "Hawaii Interisland Air Service Stability and Transformation Program" to be administered by DOTAX. New section ___-2 provides that a covered interisland air service operator is to submit an annual application to DOTAX for certification to claim the new, refundable, "Interisland air service stability and transformation tax credit" established under Section 3 of the bill as described further below.

DOTAX is to review each application for completeness. The Director of Finance shall conduct a preliminary review of the applicant's pre-credit valuation and proposed equity interest, including proposed monetization rights, and upon satisfactory review, DOTAX shall issue a certificate (subject to any conditions imposed) or deny an application (which denial may be appealed pursuant to chapter 91).

A covered interisland air service must provide quarterly reports to DOTAX,

subject to review and audit. DOTAX may require a Certified Public Accountant audit if required. A covered interisland air service that fails to submit a required audit will not be issued final certification, and failure to comply with an audit will be grounds for credit denial or recapture of the credit.

To obtain initial certification a covered interisland air service operator must issue an equity interest to the State equal to the ratio of the total credit value claimed to the pre-credit valuation, to be documented and governed by the program agreement. Failure to issue an equity interest will result in denial or recapture. The Director of Finance may require independent evaluation, updated valuations, inspection rights, reporting covenants, and monetization rights, all of which the director can establish by rule. The equity right issued will include information rights, inspection rights, and monetization rights, and the director may require anti-dilution protections, redemption features, put or call rights, registration rights, or other terms that may be reasonably necessary to avoid paper equity that cannot be realized.

The Department of Business, Economic Development and Tourism (DBEDT) is to coordinate with DOTAX and the Director of Finance in implementing this new chapter and program. DOTAX, however, is to administer and enforce this chapter and program. The Director of Finance is to receive, hold, manage, and dispose of all equity interests issued, and monitor the value and performance, exercise shareholder or ownership rights, establish procedures for valuation, monetization, or liquidation, and require update valuations as necessary.

DOTAX is to recapture the tax credit if a covered air service operator is found to submit false or misleading information, claim ineligible expenditures, fail to issue an equity interest, or otherwise violates conditions with certification, the program agreement, or this new chapter. DOTAX may impose civil penalties for chapter violations, and air service operators may be subject to criminal penalties for fraudulent claims.

DOTAX is required to submit an annual report no later than 20 days prior to the convening of each legislative session, to include credits claimed, audits conducted, compliance action taken, any recapture taken, and the equity interests held.

Section 3 of S.B. 3313 establishes the new refundable “Interisland air service stability and transformation tax credit” to be deducted from the taxpayer’s net income tax liability at 100 percent of qualified interisland expenditures incurred for the taxable year. Additionally, a qualified taxpayer may be eligible for

additional tax credits of not more than 50 percent as follows: Up to 15 percent for capital investment in fleet renewal, maintenance infrastructure, or operational facilities in the State; up to 10 percent for expenditures that improve essential interisland air cargo service; up to 10 percent for wages paid to State residents employed in operations or maintenance jobs; up to 15 percent for measuring improvements in interisland reliability, capacity, or service continuity benchmarks established in the program agreement; up to 10 percent for neighbor island hub investments and improvements; up to 10 percent for maintenance apprenticeship pipelines and workforce training programs in the State; up to 5 percent for rural or community access commitments; up to 5 percent for medical transport coordination commitments; and up to 10 per cent for agricultural freight capacity guarantees or improvements.

A qualified taxpayer claiming the credit may not claim any other income tax credit for the same taxable year, may not be allowed more than 150 per cent of qualified interisland expenditures, and the credit is transferable in whole or in part, subject to verification and approval by DOTAX.

This measure is effective July 1, 2026, with Section 3 applicable for taxable years beginning after December 31, 2026. The measure will be repealed on June 30, 2026.

DOTAX defers to the Department of Budget and Finance on the provisions relating to evaluation and approval of the equity interest, but notes the following with respect to administration of the program and the tax credit.

DOTAX notes that this new tax credit program is complex and will require significant resources to develop and coordinate.

DOTAX does not have the subject matter expertise or staffing to, among other things, certify applicants, evaluate or determine public benefit commitments, administer and otherwise evaluate compliance with the program agreement. This is an elaborate new credit program that will require significant resources and accounting to be appropriately implemented. As such, DOTAX requests that an appropriate third party with the requisite subject-matter expertise be appointed to handle certification of this credit and program.

DOTAX also recommends that if this bill moves forward, the effective date be amended to apply to taxable years beginning after December 31, 2027, to allow time for implementation.

Thank you for the opportunity to provide comments on this measure.

COMMITTEE ON TRANSPORTATION
Senator Lorraine R. Inouye, Chair
Senator Brandon J.C. Elefante, Vice Chair

DATE: Thursday, February 12, 2026
TIME: 3:01 p.m.

Support SB3313

Aloha Chair Inouye, Vice Chair Elefante, and committee members,

My name is Antoinette Davis, and I have had the honor of serving as Executive Director of the Activities and Attractions Association of Hawai‘i (A3H), a nonprofit 501(c)(6) trade organization, since 1997.

A3H supports efforts to stabilize interisland air service through the proposed Hawai‘i Interisland Air Service Stability and Transformation Program, particularly in light of the minimum wage impact study and the importance of reliable interisland connectivity to our State.

This measure would establish the Hawai‘i Interisland Air Service Stability and Transformation Program within the Department of Taxation; require a covered interisland air service operator to issue an equity interest to the State as a condition of participation; and create the Interisland Air Service Stability and Transformation Tax Credit.

Toni Marie Davis
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