Tax hike that targets isles' wealthy to expire

Imposed in 2009 because of the Great Recession, the increase will lapse at the end of 2015 as promised

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Despite concerns that the state is spending more money than it takes in each year, Gov. David Ige and state lawmakers have quietly opted to allow a $36 million-a-year tax cut to take effect for Hawaii's highest-income residents starting in 2016.

The decision to allow income tax rates to drop by as much as 2.75 percentage points for upper-income households next year is being questioned by the Hawaii Appleseed Center on Law and Economic Justice.

The Legislature is allowing that tax cut to take effect for Hawaii's wealthiest residents even as lawmakers consider extending the half-percent excise tax surcharge to raise hundreds of millions of dollars in additional taxes to support the Hono-lulu rail project.

The combined effect of those decisions would shift more of Hawaii's tax burden to lower-income residents, said Jenny Lee, a lawyer for the Appleseed center.

"We need some kind of meaningful, permanent tax reform that would increase fairness," Lee said. Hawaii's excise tax is a regressive tax that weighs more heavily on the poor than the wealthy because lower-income residents are forced to contribute a larger share of their incomes to cover the tax, she said.

The income tax issue dates back to 2009, when state tax revenues plummeted at the bottom of the Great Recession. To help balance the budget, Hawaii lawmakers increased the state's top income tax rates for Hawaii's highest-income residents.

Then-Gov. Linda Lingle vetoed that tax increase, but lawmakers overrode the Republican governor's veto.

That 2009 law increased the state's top income tax rates for the state's highest-income families and individuals in a series of steps. For example, married taxpayers filing jointly with incomes between $300,000 and $350,000 saw their maximum tax rate increased to 9 percent from 8.25 percent.

For the wealthiest joint filers, making more than $400,000, the income tax rate was increased to 11 percent from 8.25 percent. Income tax rates were left unchanged for lower-income taxpayers.

However, lawmakers in 2009 set an expiration date for those new, higher rates for the wealthiest taxpayers, and time is now running out for the higher tax rates. The law specified the increased rates would drop back down to the original level of no more than 8.25 percent for all taxpayers at the end of 2015.

When that happens, it will reduce the amount the state collects in income taxes, trimming $36 million from the projected collections for the fiscal year that begins July 1, 2016, according to a spokes-woman for the state Department of Taxation.

Meanwhile, a separate cap on itemized deductions that was imposed by state lawmakers in 2011 will also expire, which would provide another benefit to upper-income taxpayers. Lifting that cap will allow upper-income filers to further reduce their tax bills by claiming more in deductions, but the Tax Department spokes-woman said an estimate of the amount of tax revenue the state will lose as a result of that change was not immediately available.

Lee said her organization calculates the combined impact of those changes next year will mean the state will forgo $43 million it would have collected if lawmakers had acted to extend the higher tax rates and extend the cap on deductions.

Ige, House Finance Committee Chairwoman Sylvia Luke and Senate Ways and Means Chairwoman Jill Tokuda have all expressed concern that the state continues to spend many millions of dollars more each year than it collects in taxes and other revenue, and they worry the state is gradually spending down its cash reserves.

However, that concern did not translate into a successful push at the Legislature this year to extend the higher income tax rates for wealthier residents.

A spokeswoman for Ige said in a written statement that the budget Ige submitted to state lawmakers for next year assumed the higher income tax rates adopted in 2009 would expire as scheduled at the end of 2015.

The statement added that "the governor is committed to working within the state's means, examining ways to become more efficient as a way to increase revenues as opposed to raising taxes."

In other words, the Ige administration would regard a decision to retain the state's top tax rates as they are this year as effectively "raising taxes" on upper-income Hawaii residents.

Tom Yamachika, president of the Tax Foundation of Hawaii, said that when lawmakers increased those top income tax rates six years ago, they promised the public the increase would be only temporary.

The Tax Foundation does not support or oppose specific bills, he said, but "we have been traditionally been on the side of saying, ‘Look, if you lawmakers are going to promise stuff, please keep your promises,'" he said.

Yamachika also maintains the push to extend the excise tax surcharge for the rail project made it difficult for lawmakers to block the income tax cut.

"I think the lawmakers are sensitive to tax increases being piled on this year," Yama-chika said. "They know something's going to happen with rail, and I think if they passed another high-profile tax increase, voters would be really upset."

House lawmakers this year approved House Bill 886 to effectively delay the tax cut for upper-income residents for the next five years, but the measure died in the Senate after the Ways and Means Committee declined to consider it. Tokuda was unavailable to comment on the bill and its impact.

Rep. Chris Lee (D, Kai-lua-Lani-kai-Wai-ma-nalo) said he introduced HB 886 because he was interested in reducing inequality in taxation in Hawaii. He said the bill was an effort to "start the discussion focused specifically on income inequality and hopefully see if there are ways we can help address it."

"It's been a growing problem across the nation, but if there's something we can do here in Hawaii, where we have a great disparity between those who earn quite a bit and many in our community who don't, then I feel like there's room for improvement," he said.

The bill also would have increased state tax credits for the poorest Hawaii residents in an effort to offset the impact of state excise taxes imposed on food and rent.

Lee said the state has not increased tax credits for the poor to offset the impact from the state excise tax on food in almost a decade, and hasn't increased the renters' tax credit to offset the excise tax on rent in more than 30 years.

Those credits tend to ease the burden of the excise tax on lower-income residents, making the tax system more equitable, she said.