EFFECTS OF FEDERAL TAX CUTS IN HAWAI‘I: CORRECTING THE RECORD

March 28, 2018

The Department of Business, Economic Development and Tourism (DBEDT) recently released a report, "The Impact of the Federal Tax Cut and Jobs Act (TCJA) on Hawai‘i Households," which analyzed the effects of the new federal tax law on Hawai‘i households in 2018. This report, which was featured in an article in the Honolulu Star-Advertiser, concluded that the lowest-income taxpayers in Hawai‘i would see large savings from the TCJA, while those at the top would pay more.

We disagree. At both the low and high ends of DBEDT's analysis, crucial details of federal tax law appear to have been left out of their calculations. As a result, the report's conclusions mask the actual impact of the new federal tax law on Hawai‘i taxpayers at different income levels.

Only minimal tax breaks for low-income families in Hawai‘i

One of the main findings of the report is that very low-income taxpayers (those earning up to $10,000 per year) would save an average of $1,182 in 2018, due to the TCJA. DBEDT cited changes in the Child Tax Credit (CTC) as the main reason for this reported new benefit.

While the DBEDT report correctly states that the "TCJA doubles the child tax credit from $1,000 to $2,000... [and] there is an increase in the refundable portion up to $1,400," in reality lower-income families cannot receive the full $1,400. That is because the "refundable" portion of the credit is only partially refundable.

Instead, the average savings from changes to the CTC for very low-income families is actually just $75 per year.

The reason for this large discrepancy is that the maximum amount that a taxpayer can receive as a tax refund from the CTC is 15 percent of earnings over $2,500. Before the passage of the TCJA, the limit was 15 percent of earnings over $3,000. So for families earning under $10,000 per year, the actual maximum benefit that they'll receive from the CTC change is $75 (the difference between the earnings thresholds, or $500, multiplied by 15 percent).

The DBEDT report features calculations for households at different income levels. The first section of the table below draws its numbers from Appendix A of the report and looks at a family with one dependent earning $5,180 per year. DBEDT shows this family receiving a CTC refund of $1,400 after passage of the TCJA, for an increase in their refund of $1,073.

The second section of the table below looks at the same family, but it applies the CTC's partial refundability rules as explained above. Before the TCJA, the family received $327 as a CTC refund ($5,180 minus $3,000, then multiplied by 15 percent). After the TCJA, the family will be able to receive a refund of $402 ($5,180 minus $2,500, then multiplied by 15 percent). That is an increase of only $75 due to the CTC changes in the new federal tax law.

Actual tax savings for low-income families from Child Tax Cut changes much smaller than DBEDT reports			
DBEDT Report (Appendix A)			
	Before TCJA	**After TCJA**	**Tax Savings**
Household income (one dependent)	$5,180	$5,180	-
Child Tax Credit	($1,000)	($2,000)	-
Refundable Portion	($327)	($1,400)	($1,073)
Current Tax Law (Partially Refundable Child Tax Credit)			
	Before TCJA	**After TCJA**	**Difference**
Household income (one dependent)	$5,180	$5,180	-
Child Tax Credit	($1,000)	($2,000)	-
Refundable Portion	($327)	($402)	($75)

According to the Center on Budget and Policy Priorities, 31,000, or 11 percent of, keiki in low-income working families in Hawaiʻi will see only this "token increase of up to $75 per family or no increase at all."

In addition, according to the Tax Policy Center, families with more than one child will likely get an even smaller boost, while all low-income families will be facing, on average, a tax increase when many provisions of the TCJA are set to expire:

> *Families with more than one child, who already qualify for higher credits, are most likely to see a smaller increase than advertised, due to the limits on refundability....*
> *By 2027, after most of the bill's provisions directed at individuals and families expire, the lowest-income families would see an average tax increase of $160.*

In other words, low-income families in Hawaiʻi are largely left behind by the new federal tax law and will actually start seeing tax increases by 2026. It is also important to note that low-income households without dependent children – including most senior households – will not see any benefit from the changes from the new federal tax law since the only change that could benefit these households is the limited improvement to the CTC described above.

Lower taxes for Hawaiʻi's top one percent

The DBEDT report also states that it focuses on "individual income tax only." In doing so, it excludes from its calculations two of the largest breaks for individuals contained in the TCJA: the reductions in the taxes on large estates and on pass-through income. Since these are huge boons to upper-income taxpayers, leaving them out of this analysis distorts the actual comparative effects of the new federal tax law on Hawaiʻi households at different income levels.

The TCJA includes a deduction of up to 20 percent of income from pass-through businesses, whose profits are subject to the personal income tax rather than the corporate tax. A U.S. Treasury Department analysis found that 69 percent of pass-through income goes to the top one percent of households and fewer than half of taxpayers claiming pass-through income are traditional businesses. Instead, they more likely are to be, for example, self-employed individuals or claiming income from vacation rentals.

Because this 20 percent deduction will make pass-through rates lower than individual income tax rates, the TCJA will incentivize people to classify their earnings as pass-through income. Either way, income from pass-through businesses is claimed on individual income tax returns.

In addition, the TCJA doubles the exemption from the federal tax on the transfer of inherited wealth. Wealthy taxpayers will not be required to pay between 18 and 40 percent of their estate values – up to $11 million in federal tax per individual and $22 million per couple. This is a tremendous tax break for the richest among us.

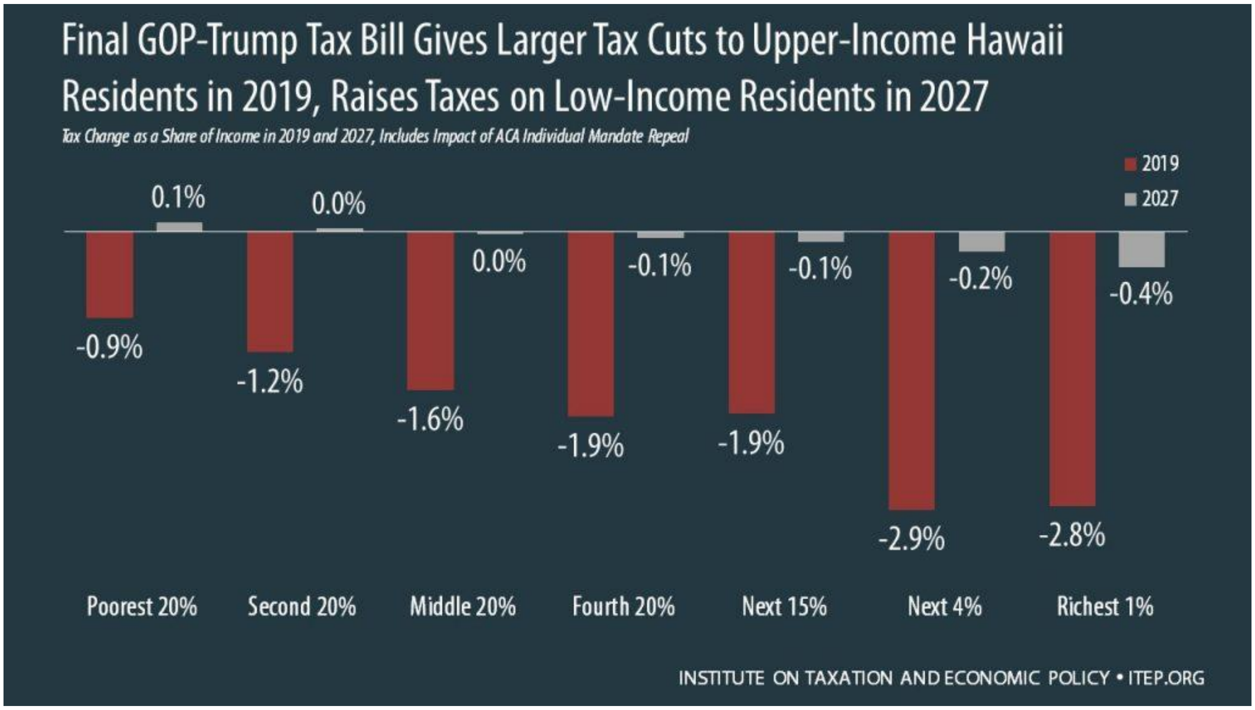
Before the passage of the new federal tax law, only the top 0.2 percent – 2 out of 1,000 – estates were taxed nationwide. Doubling the amount of inheritances that escape the federal estate tax will result in even fewer households having to pay it. The Tax Policy Center estimates that, as a result of the TCJA, less than 0.1 percent – fewer than 1 in 1,000 – of estates will be subject to the tax.

Appendix J of the DBEDT report states that households earning between $500,000 and $1 million will pay an average of $2,438 more in taxes this year due to the TCJA. For those making $1 million or more, it reports an average increase of $33,941.

In contrast, the Institute on Taxation and Economic Policy (ITEP) finds that the "richest one percent" of households in Hawai‘i – those earning over $554,230 per year – will *save* an average of $4,710 in estate taxes and $17,280 in pass-through income taxes in 2019, due to the TCJA.

Although corporate taxes are not reported on individual income tax forms, corporate tax cuts benefit those who own stocks, and the vast majority are owned by upper-income individuals. For that reason, ITEP included corporate tax breaks in its analysis of the federal tax law.

When corporate taxes are included, it turns out that the highest earners in Hawai‘i will get much larger tax breaks than those seen by taxpayers in lower income brackets. According to ITEP, in 2019 the poorest 20 percent of taxpayers in Hawai‘i will see a tax cut of 0.9 percent of their small incomes, while the richest one percent will get a tax break worth 2.8 percent of their very large incomes.



Conclusion

The TCJA is complicated and all of its provisions need to be considered in reporting the effects on households in Hawai'i. It is pretty clear that, when all the factors are included in the analysis, the TCJA significantly benefits the most affluent among us while doing almost nothing to help the people who need relief the most.