



Refunding Hawai'i



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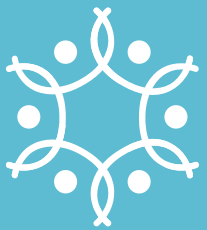
HAWAI'I BUDGET
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How expanding the state
Earned Income Tax Credit
to make it refundable can
boost the economy and
provide opportunity to
Hawai'i's working families.

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[Hawai'i Children's Action Network](#) (HCAN) is a 501(c)(3) nonprofit and the only one in the state of Hawai'i solely committed to advocating for children. We address the root causes of poverty and inequity and develop public policies that help children and their families. Our Mission: Build a unified voice educating and advocating for Hawai'i's children. Our Vision: All of Hawai'i's children are healthy, safe and ready to learn.

The [Hawai'i Budget & Policy Center](#) (HBPC) is a program of Hawai'i Appleseed Center for Law & Economic Justice. Our mission is to ensure that our state and local economic policies increase opportunity for all residents. We do this by analyzing and understanding the implications of tax and budget decisions and making sure that the public and policy-makers are informed through strategic communications, coalitions, and key partners. HBPC's work is guided by the belief that government at all levels should play an active role in helping people reach their full potential.

[Hawai'i Appleseed](#) is working to build a more socially just Hawai'i, where everyone has genuine opportunities to achieve economic security and fulfill their potential. We change systems that perpetuate inequality and injustice through policy development, coalition building and advocacy.

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INTRODUCTION

THE EARNED INCOME TAX CREDIT (EITC) is a special tax credit designed to let working families keep more of the money they earned through their work. It is a critical tool for lifting workers who are paid low wages—and especially those with children—out of poverty, and it is a highly effective economic stimulus as well, contributing up to \$1.24 in economic activity for every \$1 returned to workers as part of the EITC.¹

Many of the workers eligible for an EITC do not earn enough to cover all their basic needs, including food, housing and healthcare. The credit helps these workers provide their families with the basics and makes the tax system more equitable in the process. Research on the EITC shows that the credit contributes to long-term economic and health gains for families.

Spurred by the success of the federal EITC, first enacted in 1975, Hawai‘i and 29 other states (in addition to Puerto Rico and the District of Columbia) have created their own state EITC programs. All together, these state and federal EITC programs have benefited millions of workers from all races, ethnicities and walks of life.

People of color—who are more likely to earn low wages in Hawai‘i due to structural and historic barriers to economic security caused by colonialism and systemic racism—therefore tend to experience the greatest benefit from the EITC program, making it an effective anti-racist policy as well.

The positive impacts of the EITC are particularly

clear in Hawai‘i, where the high cost of living has made it difficult for working families to achieve lasting economic security. Hawai‘i’s cost of living is the highest in the nation, and has only increased throughout the most recent economic recession and subsequent shock caused by the COVID-19 pandemic.

In May of 2020, more than one-in-five Hawai‘i workers were unemployed, and this rate has yet to return to its pre-pandemic level. In December 2021, one-third of Hawai‘i adults lived in households that struggled to afford their usual household expenses.²

Unlike the federal EITC and the credits of most of the states with EITC programs, Hawai‘i’s tax credit has remained non-refundable since it was implemented in 2018. This means that the workers paid the lowest wages are unable to take full advantage of the Hawai‘i credit.

Given the continued hardship faced by these low wage workers, it makes little sense to continue withholding the full value of the state credit from the families most in need of financial assistance. It also makes little sense from an economic standpoint given the boost in spending the economy enjoys when low-wage workers have more money to spend. The boost provided by a refundable state EITC to families is necessary now more than ever to realize a full economic recovery in the islands.

In 2020 alone, 64,000 Hawai‘i households claimed the state EITC, totaling almost \$21 million in credits. First claimed in 2018, the state EITC expires after

The Proven Benefits of the Federal EITC

Health

- Chronic stress is known to adversely affect childhood development and long-term health outcomes. By alleviating some of the stress caused by financial insecurity, the EITC promotes physical and mental health of its recipients.
- Pregnant women who benefit from EITC are more likely to receive early, regular prenatal care. These mothers have fewer low-birthweight babies, which in turn reduces the number of children with disabilities and their associated health care costs. A \$1,000 increase in the EITC reduced the rate of low-birthweight babies by 2 to 3 percent.³

Education

- Children in EITC households are more likely to graduate from high school and college. For children between the ages of 13 and 18, a \$1,000 increase in the EITC received by their household raises their likelihood of completing high school by 1.3 percent and college by 4.2 percent. It also boosts their career earnings by 2.2 percent.⁴

Economic Support

- The EITC contributes to the economic prosperity of communities, since families with lower incomes spend most of their tax credits on essential goods. In turn, their expenditures support local merchants and jobs. According to the economist Mark Zandi, the EITC is one of the U.S. government's most effective policies for economic stimulus, providing \$1.24 in community benefits for every \$1 spent.⁵

2022 unless Hawai'i legislators act to make the credit permanent, ensuring the positive impact of the state's EITC continues into the future. Failing to do so, on the other hand, will only deepen the economic insecurity of many working families.

To create a stronger economy and a more equitable tax system, Hawai'i state lawmakers should pass legislation to make the state EITC refundable and to make the credit permanent during the 2022 legislative session.

WHY THE EITC WORKS



The EITC is both an effective anti-poverty policy and an economic stimulus for the same reason: because it targets workers with low incomes, especially those with children. These workers have the most to gain from the financial benefit of the credit itself, and are also the most likely to spend that money on necessities, circulating it within the local economy and generating additional economic activity.

The exact credit amount each family receives is determined by the income, filing status, and number of dependent children in each household. Generally, the EITC credit is smallest for households without children and largest for households with three or more children.

During the 2020 tax year, the maximum federal EITC available for filers without children was \$538, in contrast to \$6,660 for households with at least three

qualifying children.⁶ EITC recipients can subtract their tax credit from the income taxes they owe for that year.

While the federal EITC is refundable, making it fully accessible to every qualifying worker in Hawai'i, the state EITC program is non-refundable. That means it is unavailable, either in-part or entirely, to the workers paid the lowest wages.

Despite working long and difficult hours in demanding and stressful jobs, these workers earn so little on chronically low wages that they do not have a large enough tax liability to make full use of the amount of the credit. Non-refundable tax credits can, at most, reduce a tax liability down to \$0, but they cannot access any leftover amount of the credit in the form of a refund check.

To address this problem, refundable EITCs ensure that all eligible individuals—including those with the lowest incomes—are entitled to the entire value of their credit, even if it exceeds their income tax liability. Under a refundable EITC, when an individual's tax liability is smaller than the amount of the credit, they are given a refund check for the difference.

This increased refund helps working families pay for expenses that would otherwise be difficult or impossible to afford. As a result, refundable credits are more effective at both reducing poverty and stimulating the economy. In recognition of these advantages, 25 states and the District of Columbia already have refundable state EITCs.

WHO BENEFITS FROM THE EITC IN HAWAI'I?



The federal EITC was claimed by **90,000 Hawai'i households** in 2020.



The average household received an EITC worth **\$2,138** that year.



More than **1 in 7 Hawai'i residents** were eligible for the EITC in 2015.



Of these residents, **105,575 were children** in EITC-qualifying households.

In 2017, the Hawai'i State Legislature voted to create a state EITC, and the program became effective at the start of 2018 as part of Act 107 (2017). The credit amounts distributed by Hawai'i's EITC program are worth 20 percent of what its beneficiaries would receive from the federal EITC. Unfortunately, the state EITC's lack of refundability limits the actual credit that can be applied by households with the lowest incomes.

Owing to a sunset provision in the 2017 legislative bill, Hawai'i's EITC will not apply to any tax years after 2022. This provision will effectively phase out Hawai'i's EITC on December 31, 2022, unless state legislators pass a bill during the 2022 legislative session to renew it. (However, there is no such sunset for the income tax reforms also included in Act 107 that were created to pay for the original, non-refundable state EITC.)

- In 2020, the federal EITC was claimed by 90,000 households in Hawai'i. The average benefit amount was \$2,138, for a total of \$192 million in claims.⁷
- More than 1 in 7 Hawai'i residents (roughly 216,557 people) were eligible for the federal EITC in 2015, including 105,575 children in EITC-qualifying households.⁸
- In 2020, Hawai'i's state EITC was claimed by 64,007 households, for a total of \$20,983,169 in

claims.⁹ Over 92 percent of this total amount was claimed by filers who earned less than \$45,000 per year.

The impacts of the non-refundability of Hawai'i's EITC can be seen in **Figures 1 and 2**, which show that Hawai'i households with annual incomes under \$15,000 claim smaller EITC amounts on average than households with annual incomes between \$15,000–44,999. These higher-income households can make better use of the state EITC because they owe more in taxes.

Figure 1. Share of State EITC Claims by Adjusted Gross Income (2020)¹⁰

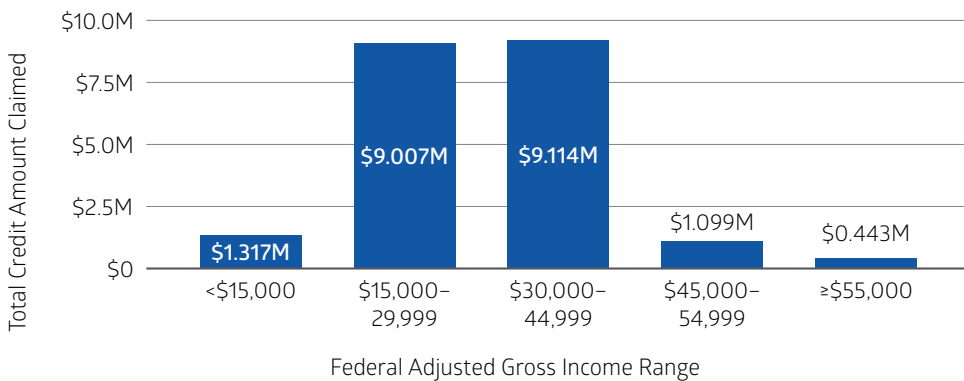


Figure 2. Average State EITC Claim by Household Income (2020)¹¹

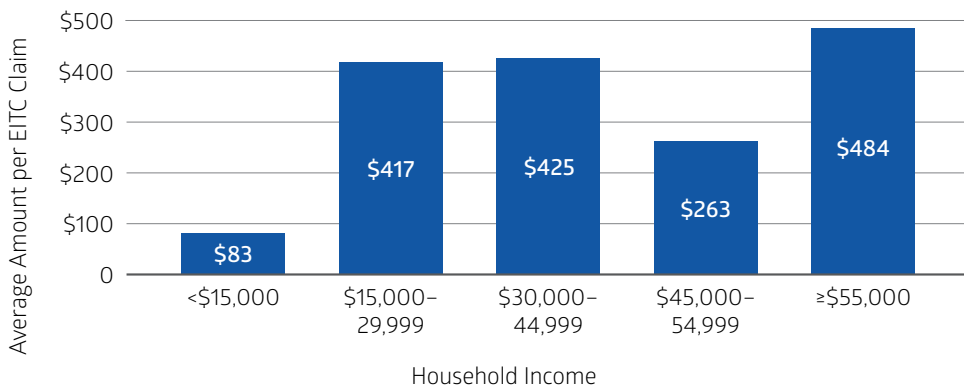


Figure 1 & 2. Hawai'i residents with incomes under \$15,000 are unable to claim the full value of the state EITC because they are paid low wages, effectively penalizing the families that would benefit the most from this tax credit.

WHY HAWAII'S STATE EITC SHOULD BE MADE REFUNDABLE

Making Hawai'i's EITC refundable would increase the benefits that are distributed to local residents, particularly for the lowest income earners:

- With a refundable program, the share of Hawai'i residents with incomes in the bottom 20 percent of earners who would see a tax cut would increase by 12 percentage points.
- Residents in this income range who already receive a tax cut through the EITC would see their average benefit increase by \$237.

The credit gains for working families above this level would be less significant by comparison, but could still see an improvement over the current benefits provided by the state EITC. **Table 1** demonstrates how refundability helps workers with the lowest incomes, ensuring that they also receive a larger portion of the state EITC benefits.



Table 1. Impact of Refundability on EITC Benefits by Income Quintile (2022)¹²

2022 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%
Income Range	<\$25,000	\$25,000–46,999	\$47,000–69,999	\$70,000–123,999
% Receiving Tax Cut Under Current, Non-Refundable Credit	17%	17%	12%	2%
Average Tax Cut Under Current, Non-Refundable Credit	\$149	\$502	\$280	\$283
Share of Total Tax Cut Under Current, Non-Refundable Credit	17%	55%	23%	5%
% Receiving Tax Cut Under Proposed, Refundable Credit	29%	18%	15%	3%
Average Tax Cut Under Proposed, Refundable Credit	\$386	\$590	\$416	\$458
Share of Total Tax Cut Under Proposed, Refundable Credit	39%	36%	20%	5%

Table 1. Expanding the state EITC to make it refundable not only puts more money into the pockets of families at all four income quintiles where families are eligible, it also better distributes that money to the families that need it the most, increasing the share of the total credit that goes to families in the lowest 20 percent of earners. The cost of a refundable credit versus the non-refundable credit is \$41 million versus \$21 million.

WHY GO REFUNDABLE?

Economic Stability

Hawai'i has the highest cost of living in the nation, yet wages for local workers have failed to keep pace with the rising costs of goods and services. In 2018, 42 percent of Hawai'i households were beneath the ALICE threshold.¹³ In effect, these households were not able to cover the cost of their basic needs.

Adding to this issue, Hawai'i's predominantly service-oriented economy has been severely strained by the COVID-19 pandemic, leading to increased economic insecurity for many local residents. At the beginning of the pandemic in March of 2020, the unemployment rate for Hawai'i was 2.1 percent. Through the subsequent two months, this rate rapidly increased to 21.9 percent. As of January of 2022, the statewide unemployment rate was 5.7 percent—still almost three times the pre-pandemic figure.¹⁴

In August of 2020, 37.5 percent of Hawai'i adults lived in households that had trouble paying for their monthly expenses.¹⁵ By December of 2021, this percentage had only slightly decreased to 33.8 percent.¹⁶ In this respect, a refundable EITC would deliver timely assistance to local residents who have felt the immense human and economic toll of the pandemic. After factoring in the EITC's economic multiplier (\$1.24 for every \$1 spent), Hawai'i's refundable EITC would also generate \$50.84 million in economic activity in the state.



Tax Equity

By increasing their credit amounts, a refundable EITC would give Hawai'i households with low incomes and many people of color the economic boost they need and deserve. In 2018, local households with incomes at the bottom 20th percentile contributed 15 percent of their income to state and local taxes. Conversely, local households in the top 1 percent contributed less than 9 percent of their income to these same taxes.

This disparity results partly from regressive taxes, such as the general excise tax (GET) that is levied on essential goods. Households with low incomes spend much more of their incomes on essential goods than households with high incomes, causing them to pay a greater share in excise taxes. Since people of color tend to have lower incomes than whites, they are also more likely to be burdened by regressive tax structures.

Racial Equity

In Hawai'i, Native Hawaiians and Pacific Islanders benefit from the state EITC at higher rates than the rest of the population, and they would stand to benefit the most from a refundable state EITC. Estimates show that 12 percent of Native Hawaiians and 18 percent of Pacific Islanders receive the state EITC, while the state average is 9 percent. This higher level of uptake speaks to the systemic barriers faced by Native Hawaiians and Pacific Islanders in terms of economic opportunities.

The ongoing impact of systemic racism in creating barriers to economic opportunity has left many Native Hawaiian and Pacific Islander families, along with other families of color, at an economic disadvantage. For much of the 20th century, European and American settlers had a dominant influence on Hawai'i's economy and politics.¹⁷

The five most powerful companies in 20th-century Hawai'i—known as the “Big Five”—were controlled by wealthy white families. Conversely, the field laborers employed by these companies were largely people of color. While the white elite consolidated

their wealth, most of the non-white population performed arduous labor for meager wages in grueling living conditions.

Native Hawaiians in particular have been forced to contend with the social and economic barriers imposed by colonialism. In 1893, a group of pro-American businessmen illegally overthrew the Kingdom of Hawai'i and seized lands that belonged to the Hawaiian monarchy.¹⁸

This dispossession—coupled with the rise of plantations—has effectively excluded many Native Hawaiians from attaining the same intergenerational wealth as settler populations.¹⁹ As a result, Native Hawaiians, who were self-sufficient in pre-contact Hawai'i, are now more likely to experience disproportionately high rates of poverty, as well as food insecurity and a range of poor health outcomes.^{20 21 22}

The “Pacific Islander” category represents a diverse mix of ethnicities, including Samoans, Tongans and multiple Micronesian ethnicities. A large segment

WHY GO REFUNDABLE?

Figure 3. Share of Each Racial Group Receiving EITC (Projected, 2022)²³

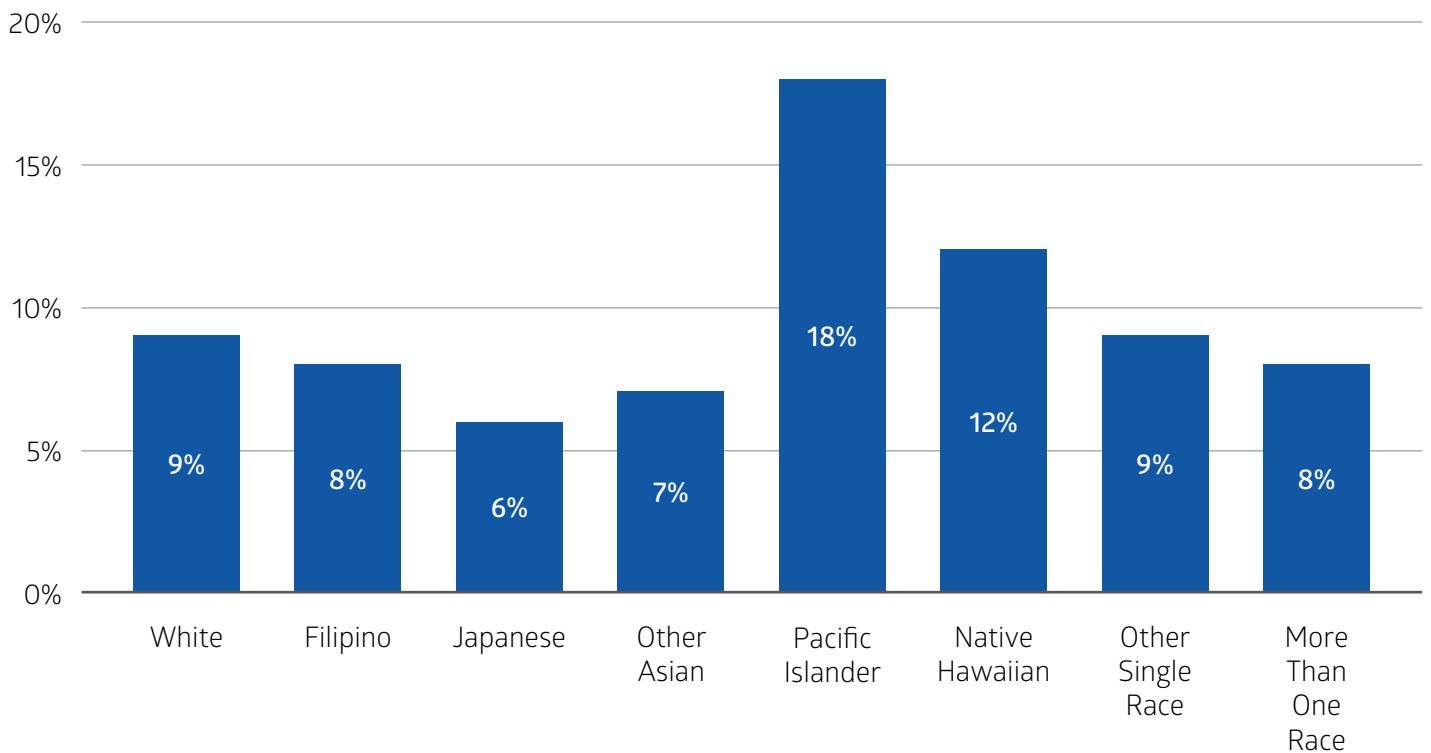


Figure 3. Pacific Islanders and Native Hawaiians have the highest uptake rates of the EITC in Hawai'i, signaling the program's impact as an anti-racist policy.

of the Micronesian community in Hawai'i is from countries within the Compact of Free Association (COFA). As part of this agreement, COFA migrants were promised healthcare and financial aid from the U.S. government, but many of those living in Hawai'i have inadequate access to these services.²⁴ Compared to the non-COFA population, COFA migrants have lower incomes and lower rates of educational attainment, among other key indicators.²⁵

Given these historical inequities, Native Hawaiians and Pacific Islanders do not have equitable access to the

generational wealth and prosperity that have been afforded to white families. Family income and wealth have a significant impact on childhood development, with children raised in higher-income families more likely to have better educational attainment and professional success.²⁶ This perpetuates a cycle of income inequality from one generation to the next for Hawai'i's communities of color.

Native Hawaiians, Pacific Islanders and Filipinos have the lowest average wages out of the major ethnic groups in Hawai'i. Moreover, households belonging

Table 2. Average Yearly Wages and EITC Benefit by Racial Group (Projected, 2022)²⁷

Ethnic Group	Average Yearly Wages (2019) ²⁸	Average EITC Benefit Among Tax Units Receiving Benefit (Non-Refundable)	Average EITC Benefit Among Tax Units Receiving Benefit (Refundable)	Difference
Pacific Islander (Alone or In-Part)	\$33,767	\$362	\$536	\$174
Filipino (Alone)	\$39,358	\$287	\$459	\$172
Native Hawaiian (Alone or In-Part)	\$41,573	\$359	\$497	\$138
Japanese (Alone)	\$56,066	\$259	\$333	\$74
White (Alone)	\$56,711	\$285	\$419	\$134
Average	\$47,554	\$311	\$450	\$139

Table 2. Native Hawaiians, Pacific Islanders and Filipinos would benefit the most from a refundable state EITC.

to these ethnic groups are more likely to include children under the age of 18. These demographic trends suggest that Hawai‘i’s non-refundable EITC does not adequately serve those who should benefit from it the most.

This is supported by estimates showing the increased

credit amounts for each ethnic group in Hawai‘i under a refundable state EITC. A refundable credit would improve the lives of recipients from all ethnicities, as the average credit amount would increase by an estimated \$139. In addition, Native Hawaiians, Pacific Islanders and Filipinos could expect to receive the largest increases to their current benefits.

PAYING FOR THE REFUNDABLE EITC

Figure 4. Estimated Tax Revenue Increase From Act 107 and Tax Credit Costs, Hawai'i (For 2022)

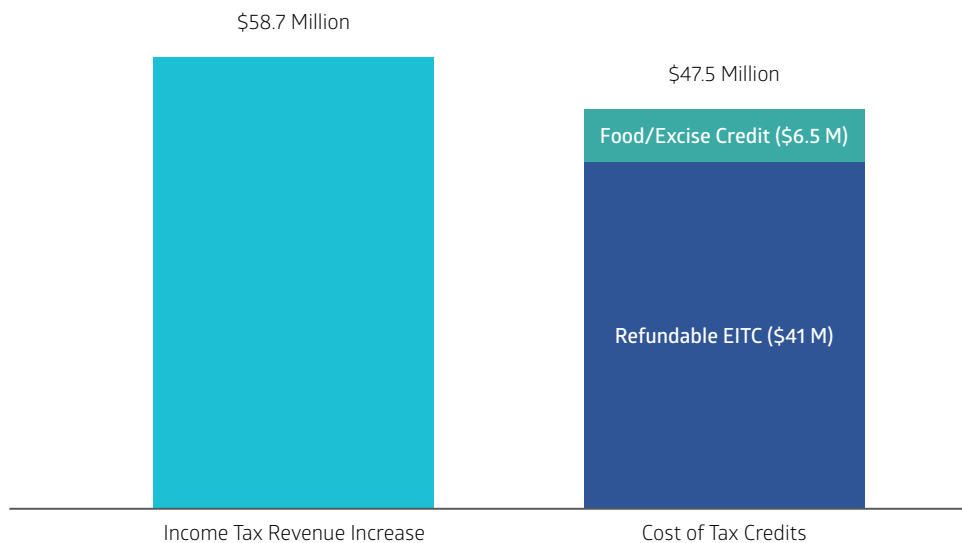


Figure 4. The cost of the refundable EITC is covered, with room to spare, by the revenue generated by the income tax reforms contained within Act 107 (2017) alone.

According to the Institute for Taxation and Economic Policy (ITEP), a refundable state EITC for Hawai'i (at 20 percent of the federal EITC) would cost an estimated \$41 million in 2022.²⁹

While this would represent a \$20 million increase in cost over a non-refundable EITC, the total cost of the program would still be covered by the income tax reforms in Act 107, which is the legislation that originally created the state EITC program in 2017.³⁰ These reforms, which re-introduced three high-

income tax brackets, do not have a sunset date and will raise sufficient revenue to pay for both a refundable EITC and a higher food/excise tax credit.

Furthermore, the estimated cost of Hawai'i's refundable EITC would be similar in cost to other tax credits. In 2022, a refundable state EITC would still cost \$9 million less than the annual \$50 million tax credit offered to film, TV and digital productions that are based in Hawai'i.³¹ Although the film tax credit has a positive impact on the local economy, the extent to

which it benefits Hawai'i residents with lower incomes is unclear.³²

Although Act 107 would pay for a refundable state EITC, this expansion could be reinforced by increasing Hawai'i's tax rate on long-term capital gains. Capital gains are the profits realized by selling assets such as stocks, properties and certain collectible items, while "long-term" capital gains are assets that have been held for more than a year.

In Hawai'i, capital gains are taxed at a lower rate than standard income, despite the fact that they are overwhelmingly attributed to the wealthiest 5 percent

of U.S. taxpayers. In 2019, 85 percent of the nation's capital gains were earned by this top 5 percent.³³ The majority of U.S. states have raised their tax rates on capital gains to at least the level of standard income; Hawai'i is one of only nine states that have yet to remove this tax break for the wealthy.³⁴

Hawai'i's taxes on long-term capital gains are currently capped at 7.25 percent, though House Bill 133 (2021) sought to increase this rate to 11 percent. Such a change would have generated an estimated \$57 million in additional tax revenue during 2022.³⁵ This would provide more than enough revenue to extend the current EITC past 2022 and make it refundable.

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