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CONCENTRATING WEALTH

The impacts of House Bill 2653 on inequality and economic security in Hawaiʻi

HAWAI‘I APPLESEED
CENTER FOR LAW & ECONOMIC JUSTICE

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Hawai‘i Appleseed is committed to a more socially and economically just Hawai‘i, where everyone has genuine opportunities to achieve economic security and fulfill their potential. We change systems to address inequity and foster greater opportunity by conducting data analysis and research to address income inequality, educating policymakers and the public, engaging in collaborative problem solving and coalition building, and advocating for policy and systems change.

The work of Hawai‘i Appleseed is about people. The issues we work on—housing, food, wages, mobility, the state budget and taxation, and racial and indigenous equity—are important because they ensure people have access to shelter, sustenance, and the means to survive and thrive individually and collectively. Addressing these issues requires the knowledge and expertise of the people that have first-hand experience and live with the adverse consequences of our flawed systems.

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EXECUTIVE SUMMARY

The economy we have today in Hawai‘i is one where a few families are able to build more wealth than anyone would ever need over the course of many lifetimes, while nearly half our population struggles for basic survival. Extreme concentrations of wealth, facilitated in part by passing down multimillion dollar estates, goes hand in hand with increasing income inequality.

Far from leading to any kind of "trickling down" of benefits from the wealthy to working families, history shows that tax policies favoring the rich hollow out the working class and diminish tax revenue that pays for public programs and services.[1] The estate tax, levied when large sums of wealth are passed from one generation to the next, ensures a more equitable distribution of resources and opportunities for all.

Introduced in the 2024 legislative session, House Bill 2653 would expand the amount of wealth that can be passed down tax-free, from the current thresholds of $11 million for married couples and $5.5 million for individuals to $27.22 million for married couples and $13.61 million for individuals. It would also entirely exempt the value of any "family-owned" business from the estate tax, no matter how much it is worth.[2]

The wealthy have already received massive estate tax cuts provided by the 2017 Tax Cuts and Jobs Act. A couple's $28 million estate that would have paid $6,753,800 in federal estate tax before 2017 would already only pay $260,000 today. That represents a nearly $6.5 million tax cut on the federal side. Under HB2653, this estate would receive an additional tax cut of $2.71 million. In all, HB2653 would cost Hawai‘i $30.2 million in the first year that it takes effect.

A progressive estate tax on multi-millionaires is a critical source of revenue to help fund our state's budget, especially in times of crisis. Spending on recovery efforts for the Maui wildfires will cost at least $1 billion in FY 2025 alone, and the total cost could reach $5.5 billion or more.[3] In addition, retroactive COVID-19 hazard pay for government workers will cost the state $150 million.[4]

Beyond these needs, Hawai‘i could dramatically improve the lives of its most vulnerable populations by investing in social programs, such as universal free school meals for children, eviction prevention and rent relief for the housing insecure, and a state-level Child Tax Credit targeted at Hawai‘i's families with children.

The proponents of HB2653 are primarily Hawai‘i business owners who have done extraordinarily well with their businesses. They may be many things—capable, well-intentioned, concerned about their employees and community, and generous in their donations—but they are not struggling businesses in need of a break.

And though they are experts at building a business and turning a profit, they are not experts at structuring a thriving economy that works for everyone. Yet it is their assertion—that this bill is good for the economy and everyone in it—that is the primary driver and justification for it. No third party analysis has ever been publicly shared with the legislature.

This brief explores Hawai‘i's estate tax, analyzes proposed changes to the tax being considered by the legislature this year, and makes recommendations for building a more fair and equitable tax code that allows Hawai‘i to invest in its people.

Expanding the estate tax exemption is the wrong choice for Hawai‘i and would curb our ability to combat rising income inequality, while depriving our budget of much needed revenue. The legislature should instead pursue progressive revenue policies such as closing the loophole in Hawai‘i's capital gains tax and raising the tax on the sale of multi-million dollar mansions through the conveyance tax.

BUSINESS AS USUAL?

At the federal level, taxes on the wealthy are lower than they were five decades ago, yet the economic reality has gotten worse for the low-income population.

- Economic mobility—the ability to climb the economic ladder—has fallen dramatically. Ninety percent of children born in the U.S. in the 1940s went on to earn more than their parents. For children born in the 1980s, the number fell to just 50 percent.[5]
- Disparities in income have grown. Between 1979 and 2007, after-tax income for the wealthiest 1 percent of households grew by 275 percent while, for the bottom 80 percent of income earners, it grew by less than 40 percent.[6]
- In Hawai‘i today, 44 percent of families do not earn enough to cover the bare-minimum costs of their basic necessities.[7]

One of the reasons for the decline in the health of our economy is misguided policies that have reduced taxes for the wealthy, higher earners, and businesses under the theory that they will be able to grow their businesses, and the benefits will filter or “trickle down” throughout the economy.

The 400 wealthiest families in the U.S. paid an effective tax rate of 56 percent in 1960. By 2018, it was down to only 23 percent—lower than the rate paid by the bottom half of U.S. households. During that roughly 60-year time period, we’ve seen the decline in economic mobility and disparities in income described above.

The results have been similar for the accrual of wealth. In 1989, the top 10 percent of Americans held 61 percent of the nation’s wealth. By 2019 they had 72 percent of it. In contrast, during the same period, the bottom 50 percent of families went from owning 4 percent of the nation’s wealth to just 2 percent.[8]

The estate tax is designed to prevent this type of wealth accumulation across generations by ensuring that the wealthiest estates pay what they owe when passed on.

Due to recent changes in tax policy, the estate tax has been severely weakened at the federal level and only applies to a small fraction of multi-million dollar estates. Hawai‘i’s current estate tax is significantly stronger than the federal tax and represents an equitable way to raise revenue and combat rising income inequality.

HOW THE ESTATE TAX WORKS

Figure 1. Hawaiʻi tax burden as a share of family income

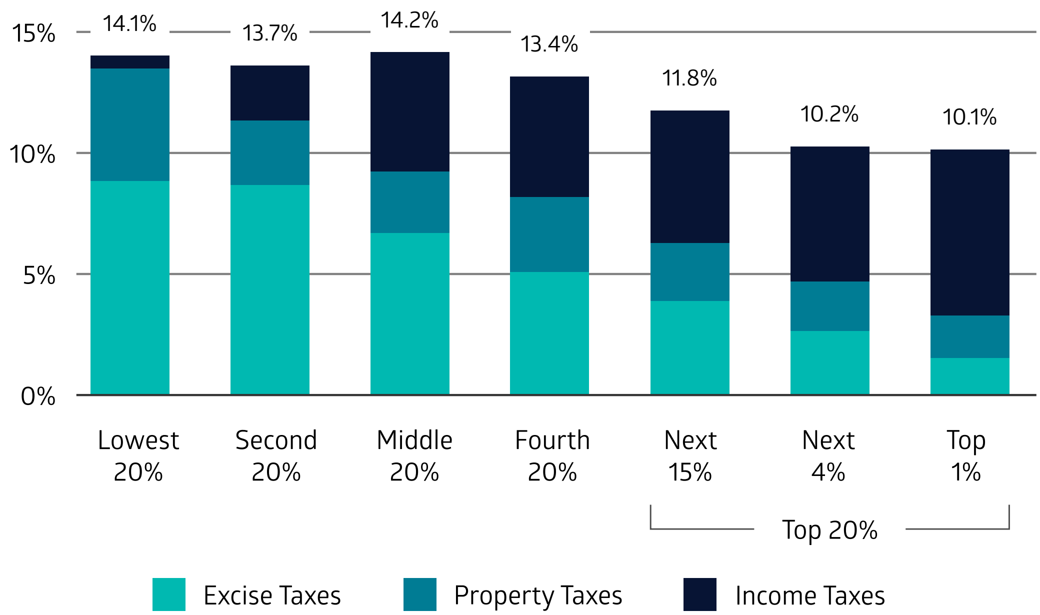


Figure 1. Hawaiʻi has a regressive tax structure overall, which means lower-income residents pay a higher share of their income in state and local taxes than those in the top 20 percent category. In this chart, the Hawaiʻi estate tax would fall under income taxes, affecting those families in the top 1 percent category.

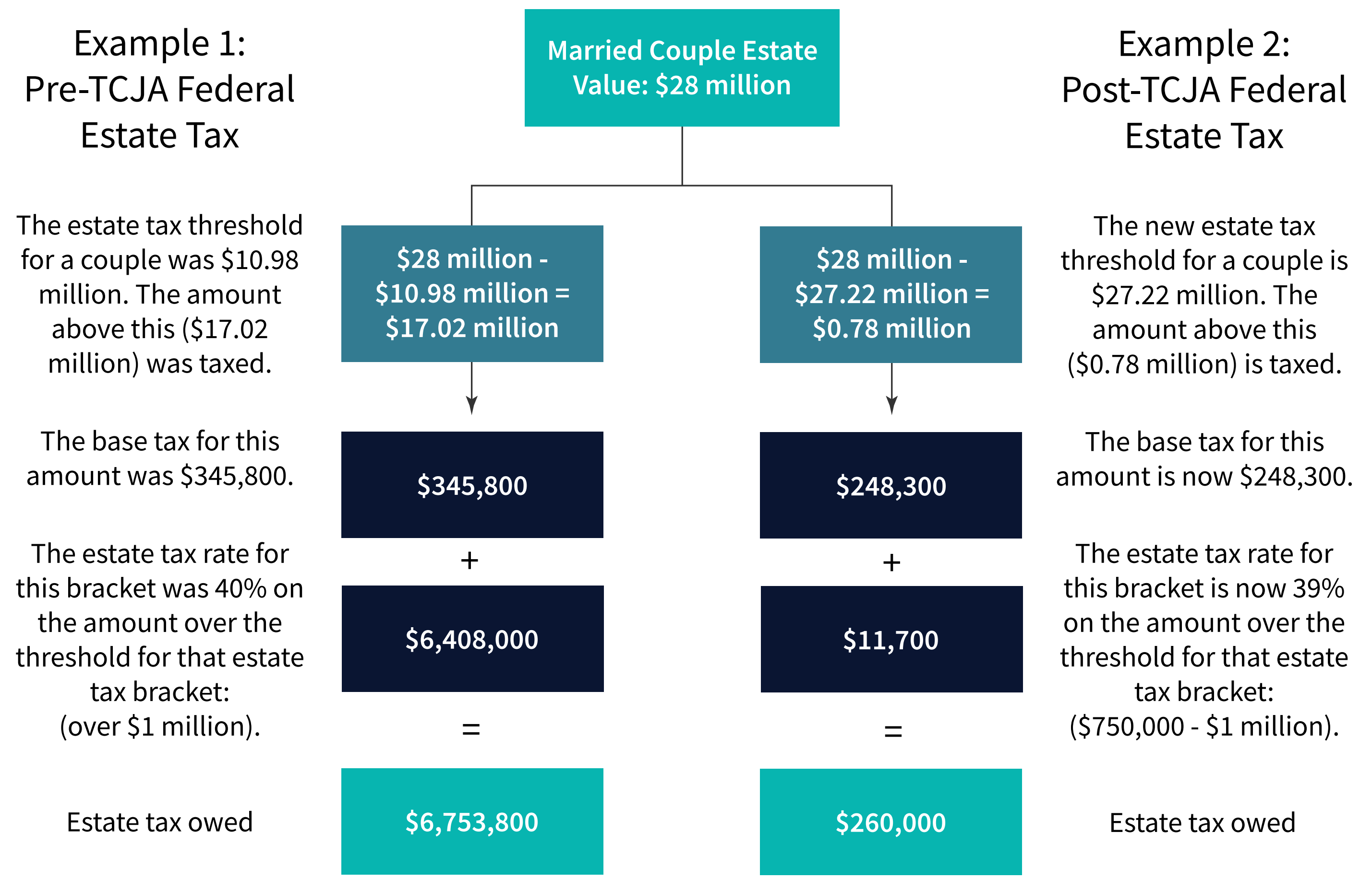
In Hawaiʻi, the estate tax shifts more of the tax burden to the highest-income households, allowing low- and middle-income households to have more breathing room with their finances.

It also raises millions in revenue for government programs and services that we all benefit from. In 2023 alone, the estate tax generated over $58.1 million, up from $57.4 million in 2022.[9] This is an important source of revenue that the state cannot afford to lose; almost half of Hawaiʻi's tax revenue comes from the General Excise Tax (GET), which increases the cost of groceries and other essential items for working families.

Overall, Hawaiʻi's tax structure puts a greater strain on low-income earners than high-income earners, mostly due to the regressive GET (**Figure 1**). In Hawaiʻi, people earning less than about $22,000 are paying an average of 14.1 percent of their income in state and local taxes, while the top 1 percent of earners (those netting about $595,000 per year) are paying a little over 10 percent of their income in taxes.[10]

The estate tax is assessed on the transfer of a deceased person's estate, with rates between 10 percent or 20 percent depending on the value of the estate. Under current law, the first $5.49 million in value for individuals or $11 million in value for married couples is exempt from the estate tax. Even if the first spouse passes away, the surviving spouse can take advantage of the marital deduction. The $5.49 million exemption threshold only applies to unmarried individuals.

Figure 2. Federal estate tax, pre-TCJA vs. Post-TCJA



Hawai‘i's current exemption thresholds match the federal exemption thresholds from 2016. However, the Tax Cuts and Jobs Act (TCJA) of 2017 more than doubled the federal estate tax exemption.

Adjusted for inflation, the exemption for one person rose to $13.61 million, and $27.22 million for couples, for the tax year 2024. This policy change significantly reduced the number of estates subject to the federal estate tax.[11]

The number of estates in Hawai‘i that were subject to the estate tax prior to the TCJA was already low. In 2016, the year before the TCJA was enacted, just 0.2 percent of estates in the U.S. were subject to the tax.[12] By 2019, the number of estates in Hawai‘i that were subject to the tax were so low that the IRS did not release any estate tax data for that year.[13]

By decoupling Hawai‘i’s estate tax from the higher thresholds implemented under the TCJA, Hawai‘i was able to preserve one of its most effective ways of taxing wealth and raising revenue.

Figure 2 compares the pre- and post-TCJA federal estate tax for an estate valued at $28 million. Under post-TCJA rules, the $28 million estate is taxed at $260,000, or about $6.5 million less than it was taxed pre-TCJA. The current tax is just 0.93 percent of the estate’s total value.

Figure 3. Hawai'i estate tax, current law vs. HB2653

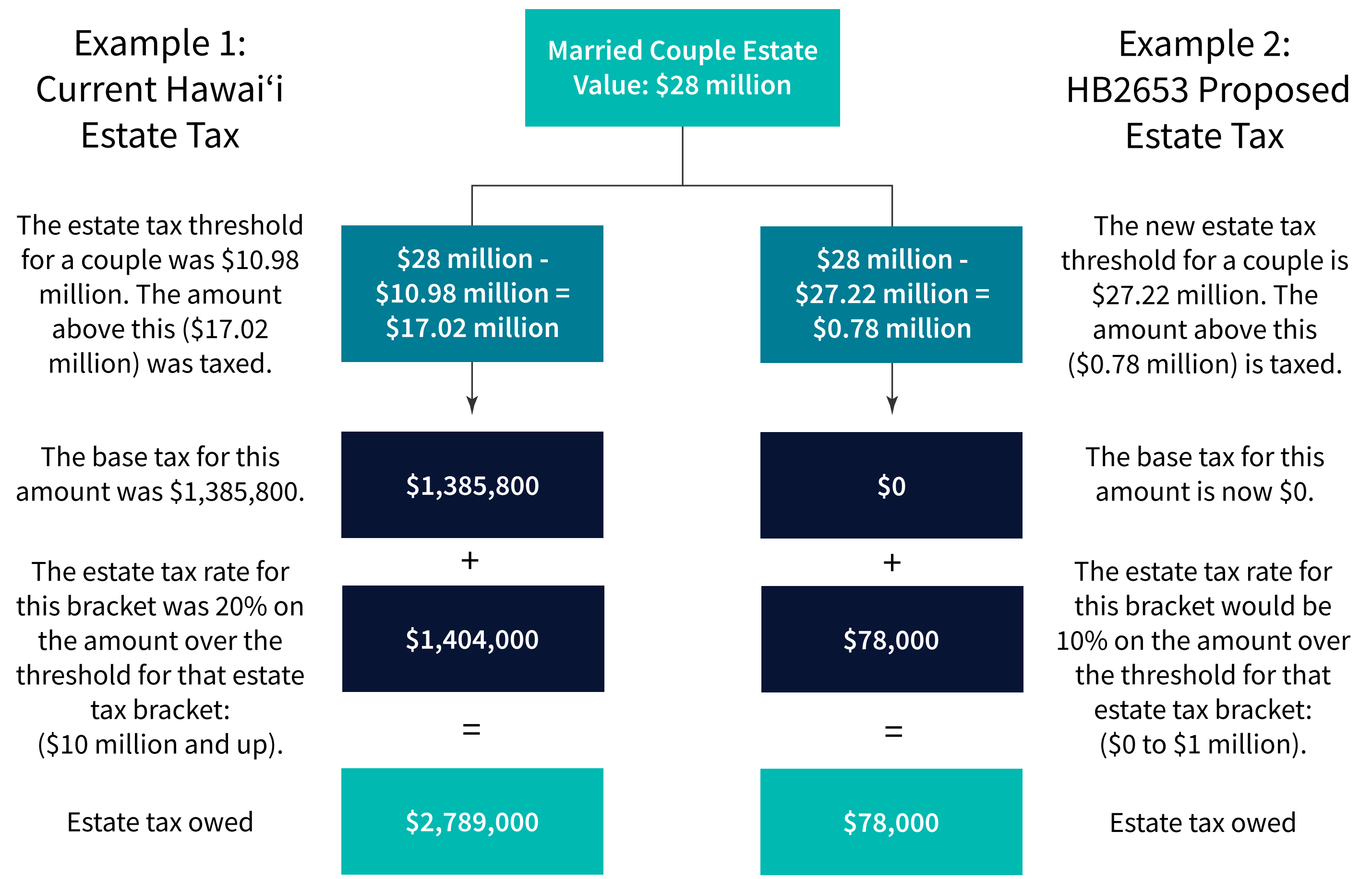


Figure 3 contrasts how the current Hawai'i estate tax works against how it would change under HB2653. Both examples are based on a married couple's estate worth $28 million.

HB2653 proposes raising the exemption threshold for the estate tax to $13.6 million for singles and $27.2 million for couples. This change would conform Hawai'i's thresholds with the federal thresholds, which in turn would drastically reduce the number of estates that could be taxed in Hawai'i.

The $28 million estate would be taxed at just $78,000, or $2.71 million less if HB2653 were passed into law. This tax would equal a tiny 0.28 percent of the estate's total value.

HB2653 also introduces a new deduction for closely held businesses. This means that if a deceased owner of an estate owns an interest in a business, the value of the business would not be subject to estate tax. This deduction, combined with the increase in the exemption thresholds, would cost the state $30 million in the first year and nearly $16 million in revenue in future years, according to public testimony from the Hawai'i State Department of Taxation.[14]

It is important to note that this estimate assumes the federal estate tax exemption amounts will revert to their pre-TCJA levels in 2025, when the changes under the 2017 law expire. If the current federal exemption thresholds are extended in 2025, revenue loss will likely remain in the $30 million range each year.

THE WRONG CHOICE FOR HAWAIʻI

HB2653 will only help a tiny fraction of Hawaiʻi's wealthiest residents.

To benefit from HB2653, a couple must have more than $11 million in assets at their death. Research shows that only 0.39 percent of the estates in Hawaiʻi owed any federal estate taxes in 2016.[15]

Most local households struggle to survive on a month-to-month basis, much less being able to afford to purchase a house to pass on their children. In fact, 44 percent of all households in Hawaiʻi do not have enough savings to pay for unexpected costs such as emergency medical care or vehicle repairs. These are the households that deserve tax relief, not multi-millionaires who would like to build more wealth.

Additionally, the small businesses that most people associate with the term “family-owned” are not actually helped by this bill. As an example, Walmart would likely qualify as a “family-owned” business were the Walton family to relocate to Hawaiʻi. Businesses owned by a single family are explicitly excluded from the tax cut, since only corporations that issue voting stock owned by two or more families qualify.[16]

HB2653 has unclear language that leaves far too much room for loopholes.

Some of the vague language included in HB2653 could leave room for several new loopholes. One such loophole is that the bill does not specifically state that the deceased person must have an interest in a business located in Hawaiʻi. This loophole means that estate tax deductions for closely held businesses could be applied to a business located outside of Hawaiʻi, just so long as its deceased owner was residing in Hawaiʻi at the time of their death.

Tax cuts on the wealthy have never lifted up the working class.

The idea of "trickle down economics," which is that tax cuts for the wealthy eventually benefit low-income workers, has never been proven to work. This is based on the premise that large tax cuts incentivize the wealthy to invest more in opening or expanding their businesses, boosting job growth and wage increases for workers. In reality, all the available evidence confirms that tax cuts for the wealthy simply allow the wealthy to keep more of their income for themselves, without providing any noticeable contribution to the working class.

The Trump Administration's series of tax cuts for the wealthy in 2017 is an excellent example of this. During that year, the corporate income tax rate was slashed from 35 percent to 21 percent, the estate tax exemption was doubled, and a portion of the foreign income for multinational corporations was exempted from U.S. tax.

This deep cut in the corporate tax rate came at a cost of $1.3 trillion over 10 years. Supporters of these corporate tax rate cuts argued that they would kickstart shared economic growth. However, research has demonstrated that none of the earnings gains from the 2017 corporate rate cuts went to the bottom 90 percent of taxpayers.[17]

There is no evidence that the estate tax has caused local businesses to fail.

HB2653 proponents argue that when the owner of a family-owned business passes away, families without sufficient money to pay the estate tax on the assets of the business will be forced to sell all or part of the business. However, many of the bill's proponents are second and third generation companies that have survived and thrived while paying much higher rates of estate tax in the past.

The federal estate tax was adopted in 1916, and historic rates have been far higher than the rates today. In 1977, estates valued at more than $120,000 (about $960,000 in today's dollars) were subject to the estate tax. The marginal tax rates ranged between 18 percent and 70 percent, depending on the value of the estate.[18] Rates have dropped from their max of 70 percent down to 40 percent. And only amounts in excess of $13.61 million are subject to the tax—an exemption that is more than 13 times the size of the estate tax exemption in 1977.

Businesses already have options to avoid the estate tax.

Business owners have the option to structure their businesses as a cooperative, where the customers are the owners (such as the Kaua'i Island Utility Cooperative), or as an employee-owned business[19] (like some 45 businesses in Hawai'i today[20]). In both cases, the wealth of the business is spread among people who are critical to the business's success, and in both cases it is exempt from estate tax.

If business owners want to preserve the wealth within their family and avoid the estate tax, they can transfer the business before they die, and no estate tax will be assessed on the businesses' assets. Of course, transferring the business means that if it is ever sold, the new owner will have to pay capital gains tax on the increase in the value of the business.

If business owners wait to pass on the business assets until after their death, and if they can get the legislature to exempt businesses from estate tax, they can avoid ever paying any taxes on the value of the business's assets.

A BETTER PATH FORWARD

In the interest of tax fairness, the legislature should pursue two policies that raise taxes primarily on the wealthiest earners. By taxing capital gains at the same rate as ordinary income and raising the conveyance tax on high-value homes, we can avoid putting more of a burden on low-income residents.

Capital Gains Tax

In Hawai‘i, capital gains—profits from the sale of assets like stocks, real estate, antiques or art—are taxed at a flat rate of 7.25 percent, regardless of the taxpayer's income bracket. In comparison, the top tax rate for income is 11 percent, and Hawai‘i is only one of nine states in the country that provides a lower tax rate for capital gains income over income from regular wages. This mostly benefits the highest earners in Hawai‘i, who accounted for over 77 percent of the $3.9 billion in capital gains in 2020.

Since the tax rate on capital gains is capped at 7.25 percent, wealthy individuals are able to avoid the top income tax rate of 11 percent on large portions of their income,[21] serving to perpetuate income inequality.

To fix this loophole in our tax code, Hawai‘i should reform its capital gains tax to follow the same progressive rates as ordinary income tax. This would mean that someone in the 11 percent income tax bracket would pay a fair tax rate of 11 percent on their capital gains income as well.

Taxing capital gains at the same rate as ordinary income is estimated to generate an additional $134.8 to $166.9 million in annual revenue, providing much-needed funds for Hawai‘i's many needs through a more equitable tax system.[22]

Conveyance Tax

The conveyance tax is a state tax applied only once during the sale of real estate, and it is typically paid by the seller. The revenue generated from this tax, often referred to as the “mansion tax,” directly supports the development of affordable housing and the conservation of land and natural resources—although there are currently arbitrary caps on the amount of money that can go to these funds.

The state needs about 11,857 new homes every year to keep up with demand, which is primarily fueled by low-income residents. In addition, creating a 10 percent allocation for the Dwelling Unit Revolving Fund would help pay for the infrastructure needed to build more affordable housing.

Hawai‘i’s housing market is focused more on generating profit than on providing homes for local residents, making housing unaffordable for those who need it the most. At the moment, the conveyance tax on selling multi-million dollar houses is relatively small, ranging from 0.50 percent to 1.25 percent of the property's value. The legislature should take the opportunity to raise this tax rate on high-value real estate and invest the revenue in affordable housing for working families.[23]

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