HAWAIʻI APPLESEED
CENTER FOR LAW & ECONOMIC JUSTICE

HAWAIʻI BUDGET & POLICY CENTER

FUND OUR FUTURE
PROGRESSIVE REVENUE RAISERS - 2024

Creating a New Individual Income Tax Bracket

In Hawaiʻi, the difference in income tax rates across the board is small, with a top rate of 11 percent for incomes at $200,000 and above for a single filer. This means that an individual who earns millions of dollars per year has their income taxed at the same rate as someone who makes $200,000 per year. The state could more evenly spread the tax burden across people of all incomes if it created a new income tax bracket that targets high earners. Individuals earning $300,000 as single filers or $600,000 as joint filers can afford to pay their fair share in taxes. There are a number of rates that could be tied to this tax bracket, depending on the amount of revenue the state wants to generate. For this recommendation, we modeled our estimates on marginal tax rates of 11.5 percent, 12 percent, and 13 percent. This proposal would generate between **$16–64 million** in new revenue each year.

Increasing the Capital Gains Tax

To make our tax system more fair in Hawaiʻi, we should tax capital gains at the same rate as ordinary income. Capital gains are the profits people make when they sell capital assets that have gone up in value. These assets include things like stocks, art, antiques or real estate. In Hawaiʻi, the tax rate for long-term capital gains is 7.25 percent, no matter how much a taxpayer makes. This means wealthy people pay a lower tax rate on their capital gains than they do on their regular income. In 2020, resident and non-resident taxpayers in Hawaiʻi claimed over $3.9 billion in capital gains income. Over 77 percent of these profits went to the wealthiest taxpayers who earned $400,000 a year or more in regular income. Hawaiʻi's favorable 7.25 tax rate on capital gains allows this group to avoid paying the top 11 percent rate they should be paying on all of their income.

Taxing capital gains at the same progressive rates as ordinary income would make the wealthy pay their fair share. In 2023, this idea was proposed by the Hawaiʻi State Legislature in House Bill (HB) 232. The Legislature also considered HB337, a weaker bill that would have taxed capital gains at a rate of 9 percent instead of 7.25 percent. Neither bill survived to the end of the session. It is estimated that this increase to the capital gains tax would generate **$87 million** in revenue for 2024. The vast majority of the projected tax burden (85.4 percent) would fall on the wealthiest taxpayers in Hawaiʻi, since they can afford to invest their money in assets.

Reforming the Conveyance Tax

The conveyance tax is a one-time tax levied on the sale of real property in the state. Under this tax, home sales are taxed at progressively higher rates depending on their sale value. Half of the revenue from this tax, or $38 million—whichever amount is lower—is currently dedicated to the Rental Housing Revolving Fund (RHRF). This fund is used as gap-financing for the construction of Low Income Housing Tax Credit (LIHTC) projects that provide affordable units for those making 0–60 percent of the Area Median Income (AMI), as well as the Tier 2 Program that funds construction of affordable workforce rental housing at 60–100 percent AMI.

Projections estimate that more than 50 percent of our housing production going forward needs to be affordable rentals for low-income and workforce families, so boosting the revenue deposited into the Rental Housing Revolving Fund should be a priority for the state. Because the conveyance tax is tied directly to the RHRF, finding ways to capture more revenue from the sale of multimillion dollar mansions is an equitable way to accomplish this goal. As one of the only dedicated revenue sources for affordable housing in our tax code, progressively increasing conveyance tax rates to target high-end, luxury real-estate sales, and lifting the current conveyance tax revenue caps will drive more funding to affordable housing development. Depending on the details of this tax reform, Hawaiʻi could generate between **$103–300 million** in additional revenue from this tax.

Closing the Estate Tax Loophole

Taxes on estates and inheritance are highly progressive. They help reduce the concentration of property and income by taxing the transfer of wealth from one generation to the next. Hawai‘i's estate tax rates are 10 percent on the first $1 million or less, increasing to 20 percent for estates valued at more than $10 million. However, there is no tax on the first $5.49 million of an estate, and the rate is marginal. Revenues from the estate tax vary considerably from year to year: they were as low as **$19 million** in 2019 and as high as **$57 million** in 2022. However, they are likely to increase in coming years as the population ages and real property values increase. We recommend improving the progressivity of Hawai‘i's estate tax by reducing the exemption from $5.49 million to $2.75 million or less.

Increasing Corporate Tax Rates

The vast majority of businesses that filed taxes in 2019 were not subject to the Corporate Income Tax. Most were sole proprietors, partnerships, or other types of businesses that are exempt. However, businesses incorporated as C corporations—usually larger, wealthier, and sometimes multinational companies—are subject to Hawai‘i's Corporate Income Tax. Despite making up only 8 percent of businesses in the state, these corporations generate $83 billion in annual receipts, or 59 percent of the total for all businesses. These corporations benefit from public investments in Hawai‘i's education, infrastructure and environment, but they contribute less than 0.25 percent of the state government's revenues—the lowest among all states. Some 38 states and the District of Columbia tax corporate income or gross receipts at a higher rate than Hawai‘i.

Hawai‘i uses a marginal tax system for corporate income, with three tax rates: 4.4 percent, 5.4 percent and 6.4 percent. The state taxes corporate capital gains income at a flat rate of 4 percent, and any additional income is taxed according to the appropriate income tier. In 2019, the average tax rate for taxable corporations before tax credits was 5 percent, but after taking advantage of credits, corporations paid only 3 percent on their profits. A report prepared for the Tax Review Commission in 2017 identified three strategies to increase corporate tax revenues, as follows:

1. Tax corporate income at a flat rate of 9 percent. Estimated revenue gain in 2023 was **$185 million**.
2. Keep tiered tax brackets but increase the rates by 50 percent. Estimated revenue gain in 2023 was **$75 million**.
3. Increase the corporate capital gains income tax rate from 4 to 5 percent. Estimate revenue gain in 2023 was **$12 million**.

We recommend both imposing a single corporate income tax rate of 9 percent and increasing the capital gains tax to 5 percent. This would result in an estimated gain of **$200 million** in corporate tax revenues per year.

Worldwide Combined Reporting

Multinational corporations profit from Hawai‘i's natural beauty, people and culture, but they use accounting tricks to avoid paying taxes here. These corporations have taken advantage of tax breaks around the world, typically by moving their profits from one country to another. They do this by setting up subsidiaries in countries with little to no corporate income tax—also known as tax havens. Corporations have exploited this loophole to cheat the U.S. government out of billions in tax dollars. In 2019, it was estimated that the U.S. lost $14.19 billion in tax revenue to corporations due to the use of foreign tax havens.

Like most states, Hawai‘i already enforces combined reporting, a tax policy that makes corporations report all of their income across the U.S. This holds corporations accountable for the profits they move between states, but it does not prevent them from transferring their profits to foreign tax havens. In order to solve this issue, some tax advocates have called for a more comprehensive worldwide combined reporting, forcing corporations to report their income from both the U.S. and foreign countries. Worldwide combined reporting treats multinational corporations and their subsidiaries as a single business for tax purposes. This ensures that the government can tax corporations based on where they do business, not simply where they decide to report their profits.

Estimating the revenue impact of combined reporting is challenging because much of the data on corporate profits is either incomplete or unavailable. However, policy experts have found that multinational corporations store away billions of dollars in foreign tax havens each year. By enacting combined reporting laws that include foreign tax havens, states collectively could see a revenue boost. Hawai‘i alone could see **$38 million** in additional revenue.