FUNDING HAWAI‘I’S FUTURE

OCTOBER 2023

HAWAI‘I BUDGET & POLICY CENTER

HAWAIʻI'S TAXES pay for programs and services that we all need, from building roads and maintaining parks to constructing affordable housing and climate change-resistant infrastructure. Unfortunately, our system puts a lopsided financial strain on struggling families, while the wealthy continue to receive tax breaks.

In this report, we look at how Hawaiʻi taxes lower-income residents more heavily in comparison to higher-income residents. Then, we examine options to raise taxes on wealthy residents and corporations, so that they contribute their fair share towards the public good.

The Hawaiʻi Budget & Policy Center is a program of Hawaiʻi 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.

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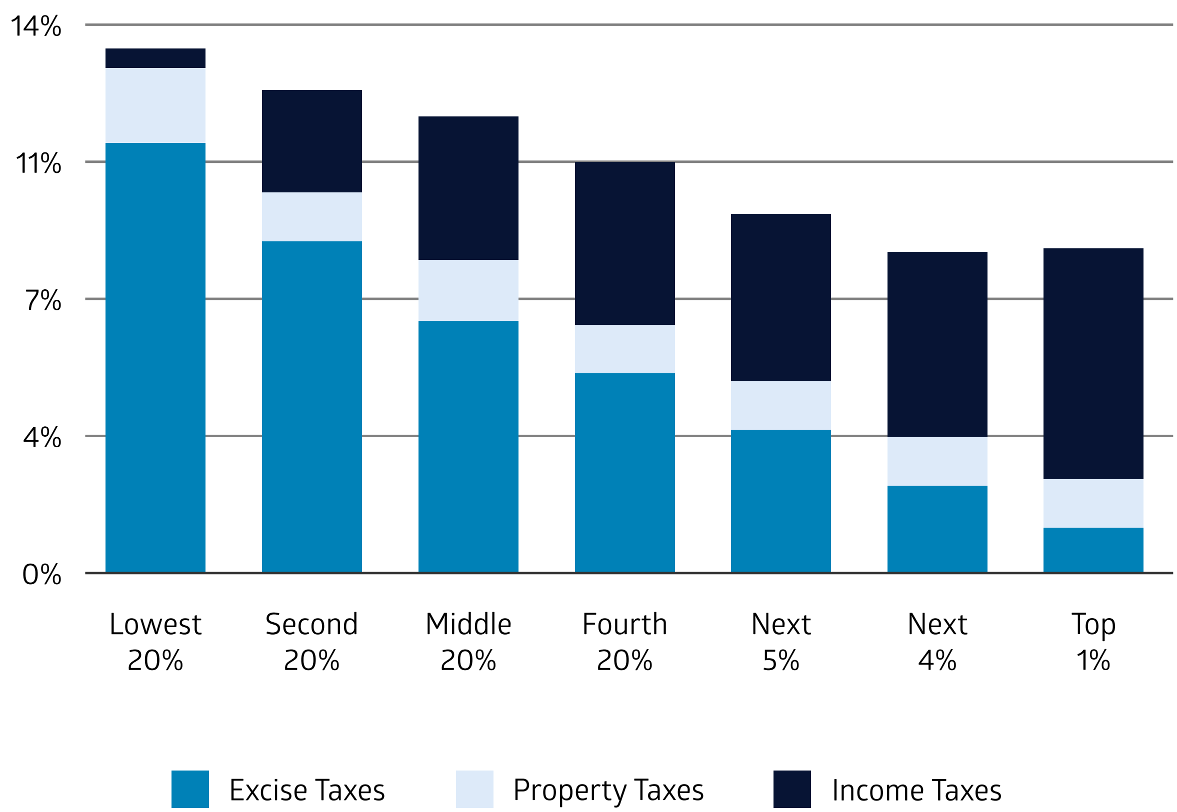
UNEVEN TAXATION

EVEN THOUGH HAWAI‘I HAS A PROGRESSIVE TAX SYSTEM ON PAPER, LOWER-INCOME TAXPAYERS STILL HAVE A DISPROPORTIONATELY HIGH TAX BURDEN.

Figure 1. Percentage of Income Paid in Hawai‘i State Taxes



Source: Institute on Taxation & Ecnomic Policy’s “Who Pays” report.[1]

The lowest 20 percent of taxpayers spend almost twice as much of their income on taxes compared to the top 1 percent. One of the main reasons behind this is the General Excise Tax (GET), which is a tax on goods and services. Local supermarkets pass the cost of the GET on to consumers, making groceries even more unaffordable for struggling families.

In 2020, Hawai‘i residents who earned more than $1 million received an average of $37,500 in tax credits.[2] In comparison, residents with incomes of $50,000 or less claimed tax credits that averaged less than $150. Low-income residents have access to tax credits like the Earned Income Tax Credit ($260 per household in 2021) and the Refundable Food/Excise Tax Credit ($116 per household in 2020), but in high-priced Hawai‘i these are too small to make families financially secure.

HAWAI'I'S MARGINAL TAX RATES

Table 1. Income Tax Brackets for Hawai'i

Single	Married Filing Jointly	Tax Rate
\$0–\$2,399	\$0–\$4,799	1.40%
\$2,400–\$4,799	\$4,800–\$9,599	3.20%
\$4,800–\$9,599	\$9,600–\$19,199	5.50%
\$9,600–\$14,399	\$19,200–\$28,799	6.40%
\$14,400–\$19,199	\$28,800–\$38,399	6.80%
\$19,200–\$23,999	\$38,400–\$47,999	7.20%
\$24,000–\$35,999	\$48,000–\$71,999	7.60%
\$36,000–\$47,999	\$72,000–\$95,999	7.90%
\$48,000–\$149,999	\$96,000–\$299,000	8.25%
\$150,000–\$174,999	\$300,000–\$349,000	9%
\$175,000–\$199,999	\$350,000–\$399,000	10%
\$200,000 and above	\$400,000 and above	11%

The state's income tax rates for single filers range from 1.4 percent (for incomes under \$2,400) to 11 percent (for incomes over \$200,000). However, the state's income tax is a marginal, rather than a fixed, rate on taxable earnings. This means that taxpayers do not pay the same rate on all of their income—they pay the rate that applies to each slice of their income.

For example, a person who earns \$200,000 would not pay an 11 percent tax on that full amount (which would equal \$22,000). Instead, they would pay a 1.4 percent tax on the first \$2,399 of their income, a 3.2 percent tax on the income between \$2,400 and \$4,799, and so on. Overall, this person would pay a little over \$16,000 with these marginal rates, which is much less than what they would pay under a fixed rate.

PROGRESSIVE REVENUE OPTIONS

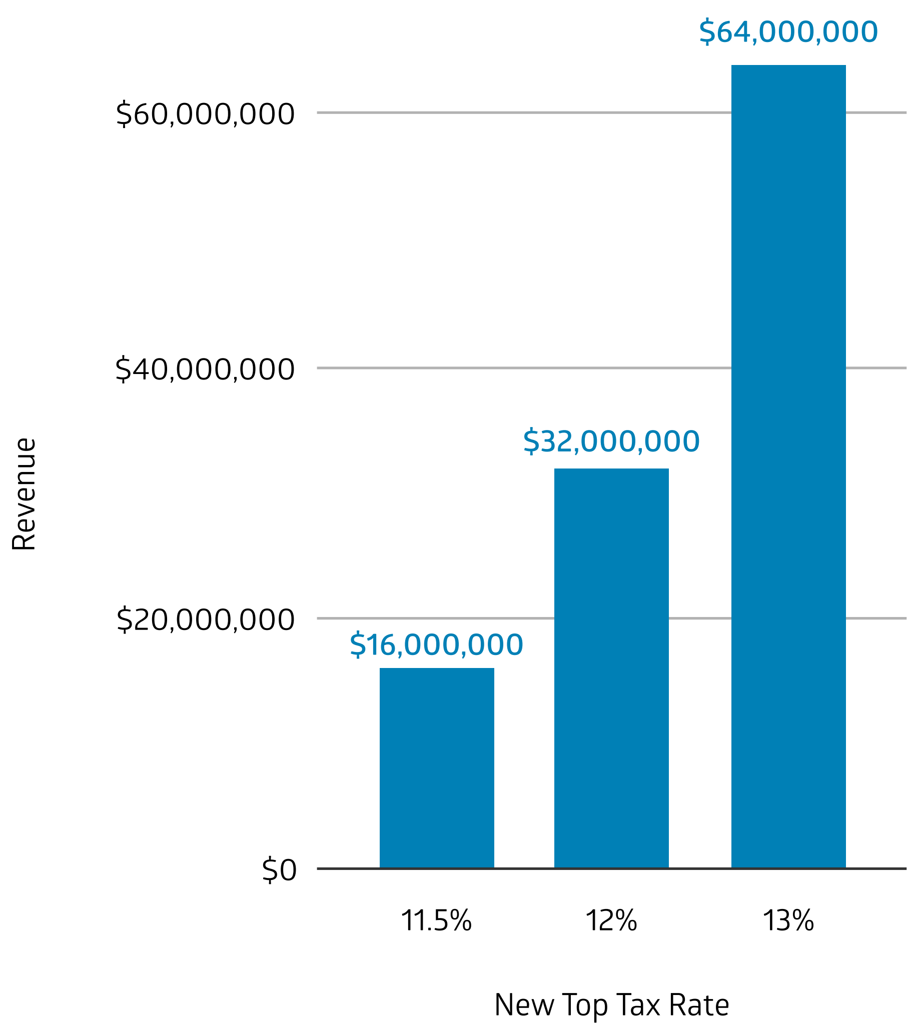
Hawaiʻi's tax system is not progressive enough to compensate for rising income inequality. Several strategies are available to ensure that the wealthiest taxpayers—Hawaiʻi's 1 percent—pay their fair share. In addition, corporations, which benefit from public investments in education, infrastructure and the environment, are taxed at low rates and contribute little to state revenues.

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.

Figure 2. Estimated Revenue from New Income Tax Bracket, Hawaiʻi (2024)[3]



INCREASING THE CAPITAL GAINS TAX

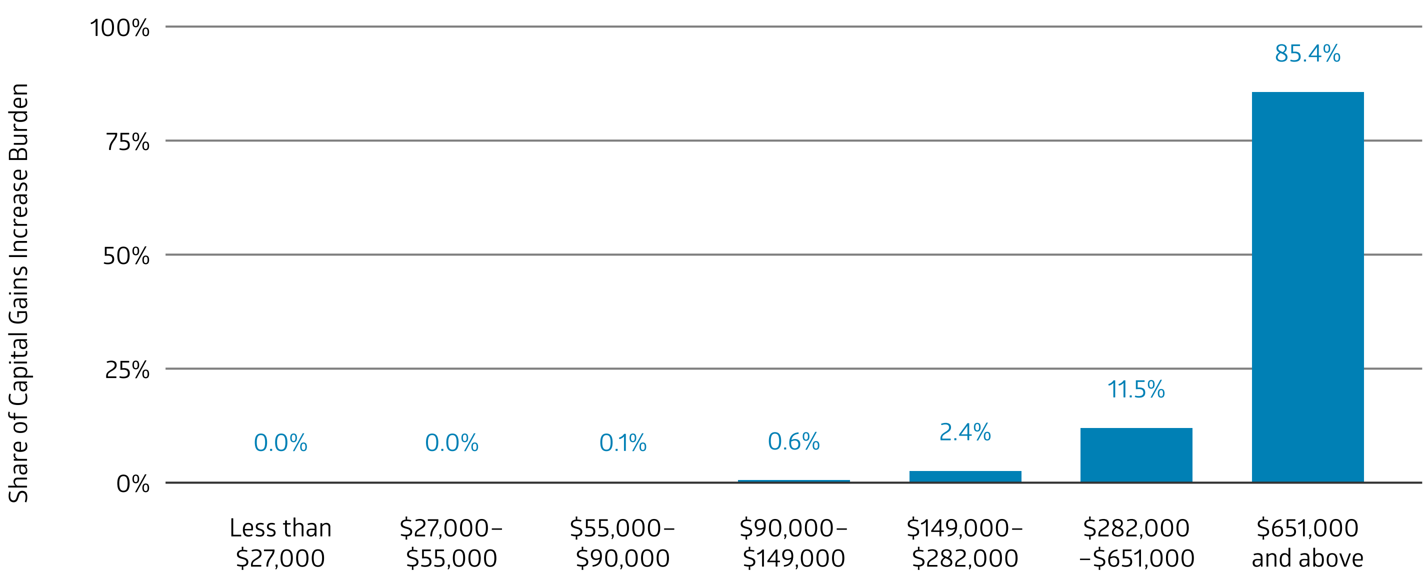
To make our tax system more fair in Hawaiʻi, we should tax capital gains at the same rate as ordinary income. Capital gains are the profits people make when they sell capital assets that have gone up in value. These assets include things like stocks, art, antiques or real estate. In Hawaiʻi, the tax 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.[4] 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.

Figure 3. Share of Capital Gains Tax Increase by Income Bracket, Hawaiʻi (2024)[5]



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. 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 this fund, 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.[6]

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[7] and as high as **$57 million** in 2022.[8] 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.[9]

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.[10] Some 38 states and the District of Columbia tax corporate income or gross receipts at a higher rate than Hawai'i.[11]

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.

	Rate for Income up to $25,000*	Rate for Income $25,000-$99,999*	Rate for Income $100,000/more*
Hawai'i Rate	4.40%	5.40%	6.40%
Average U.S. Rate	5.63%	6.03%	6.91%
Highest U.S. Rate	6.50%	8.50%	11.50%
31 states and the District of Columbia use a single rate that averages 6.50%			

**Rate brackets are approximate as states use a variety of income bands that may not be the same as Hawai'i's.*

A report prepared for the Tax Review Commission in 2017[12] identified three strategies to increase corporate tax revenues, as follows:

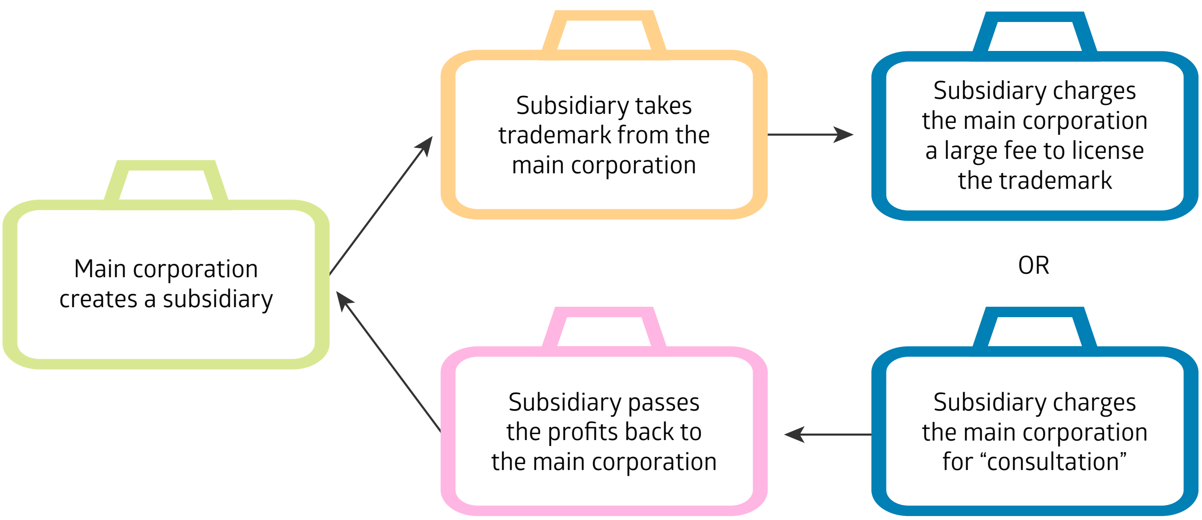
1. Tax corporate income at a flat rate of 9 percent. Estimated revenue gain in 2023 was **$185 million**.
2. Keep tiered tax brackets but increase the rates by 50 percent. Estimated revenue gain in 2023 was **$75 million**.
3. Increase the corporate capital gains income tax rate from 4 to 5 percent.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

One strategy used by corporations is to give a trademark to one of their subsidiaries. Then, the subsidiary "charges" the parent corporation a fee to use this trademark. By doing this, corporations can easily funnel money to subsidiaries and keep the profits that otherwise would have been taxed. 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.[13]



Like most states, Hawaiʻi 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. In the 1980s, states like California passed laws that mandated worldwide combined reporting, but corporate lobbyists fought to introduce loopholes that made it optional. Alaska requires worldwide combined reporting for oil companies.[14]

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. Hawaiʻi alone could see **$38 million** in additional revenue.[15]

FUNDING PRIORITIES

While it is important to make the wealthy pay their fair share in taxes, the resulting revenue should be invested in programs that lift up Hawai‘i’s residents. Government programs, such as tax credits, food security supports, and affordable housing, are excellent ways to ensure that progressive taxes help families in need.

1. **Tax Credits**

   Refundable tax credits like the Child Tax Credit (CTC) and Earned Income Tax Credit (EITC) provide crucial assistance to working families in need. These credits are linked to improved health, education and economic outcomes. Building on the success of the federal EITC, Hawai‘i enacted its own state-level EITC in 2017 and made it fully refundable in 2021.

   The legislature now has the opportunity to continue this progress by establishing a state-level Child Tax Credit or “Keiki Credit,” which would help working families cope with the high cost of raising a family in Hawai‘i. We estimate that a $600 credit for all children aged 0–18 would require an investment of roughly $84 million annually from the state. This could be fully paid for by closing the state’s capital gains tax loophole, which would generate between $87–$130 million annually for the state.

2. **Food Security**

   A $35 million investment in Universal Free School Meals would enhance students’ health and learning by offering nutritious meals to all, regardless of income. This initiative also aids low-income families, saving them money and time while promoting sustainable agriculture.

   The DA BUX program, which doubles SNAP recipients' benefits when purchasing local fruits and vegetables, could greatly benefit from a $3 million investment. This investment alone could lead to over $9.9 million in economic activity for Hawai‘i, and it could bring in an additional $3 million in federal matching funds.

3. **Affordable Housing**

   Housing is often the most expensive item in the budgets of working families. Some 59 percent of low-income households are cost burdened, meaning they spend more than 30 percent of their monthly income on housing. These costs will continue to rise as the high demand and limited supply of housing units continues to put upward pressure on rents. This in turn puts additional pressure on the monthly finances of low-income renters who are already struggling to keep up with the rising costs of other basic needs.

   To combat the lack of affordable housing, the state needs to make large scale investments in the construction, acquisition, and/or rehabilitation of affordable housing rentals for local working families. While the state does invest millions each year in affordable housing, mostly through one-time appropriations, these investments need to ratchet up if they are to effectively address our housing needs. However, doing so requires an increase in dedicated revenue for affordable housing.

ENDNOTES

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