HAWAI'I KIDS COUNT

JANUARY 2022

Tax Credits as Tools to Advance Prosperity

Hawai'i Children's Action Network

Hawai'i Budget & Policy Center

Hawai'i Appleseed Center for Law & Economic Justice

Tax credits can fine-tune the tax system to promote social welfare and encourage economic activity by delivering targeted tax relief.

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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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HAWAI‘I'S TAX CREDITS

In 2019, Hawai‘i granted more than $300 million in tax credits, a sum equal to 10 percent of all individual and corporate income taxes collected that year. This report discusses the purpose and amount of Hawai‘i's tax credits and shows who benefits from them.

TAX CREDITS are among the tools the state uses to invest in people, businesses and the environment. Instead of appropriating state funds for these investments through the budget process, tax credits meet the state's objectives by reducing the tax liability of qualified individuals and businesses in order to:

- Promote social welfare;
- Encourage certain industries or economic activities; or
- Avoid double taxation or pyramiding of Hawai‘i taxes.

Tax credits enable taxpayers to reduce their tax liability on a dollar-for-dollar basis (unlike tax deductions, which reduce the amount of income that is taxable). A tax credit may be "refundable," meaning the government sends a payment to the taxpayer if the tax credit is more than the tax liability. Alternatively, a tax credit may be "nonrefundable," in which case it can be used only to offset the tax liability. However, nonrefundable credits can usually be carried forward for use against tax liabilities in future years.

State tax credits are passed by the legislature and signed into law by the governor. They cover a variety of situations and may be used to reduce tax liability for individual and corporate income taxes, as well as the taxes on insurance premiums, financial corporations, fiduciaries and exempt organizations.

Table 1 on the next page shows the most significant tax credits during 2019 ranked by amount. The number of claims and average amount per claim are also shown.

When examining tax credits that promote social welfare, in general they are widely claimed, indicating their value to residents, but for low average claims (LIHTC—a credit that assists in the development of affordable housing—being the exception). On the other hand, tax credits that promote certain industries and economic activity are claimed by few but provide much larger claims to those able to obtain them.

Table 1. Top 5 Tax Credits in 2019 by Total Amount

Top 5 Tax Credits	Amount	Number of Claims	Average per Claim
1. Renewable Energy	$60.3 M	9,036	$6,675
2. Income Paid to Another State or Country	$56.4 M	10,222	$5,522
3. Motion Picture, Digital Media, and Film Production	$38.9 M	25	$1,555,720
4. Capital Goods	$37.7 M	4,409	$8,544
5. Food/Excise	$28.4 M	240,158	$118
Credits to Promote Social Welfare Only			
1. Food/Excise	$28.4 M	240,158	$118
2. Low-Income Housing (LIHTC)	$25.3 M	37	$683,568
3. Earned Income (EITC)	$18.1 M	61,406	$295
4. Child & Dependent Care	$8.7 M	22,792	$384
5. Low-Income Renters	$2.0 M	20,530	$99
Credits to Promote Economic Activities Only			
1. Renewable Energy	$60.3 M	9,036	$6,675
2. Motion Picture, Digital Media, and Film Production	$38.9 M	25	$1,555,720
3. High Tech Business Investment (Expired)	$13.3 M	231	$57,671
4. Research Activities	$3.8 M	52	$72,481
5. Capital Infrastructure	$3.2 M	94	$33,553

Table 1. The top five tax credits in terms of the amount the State of Hawai'i spends to provide them includes just one tax credit promoting social welfare: the food and general excise tax credit. This credit is claimed by 240,158 Hawai'i residents for an average of just $118.

POLICY RECOMMENDATIONS

Tax credits are an important aspect of public policy, but are often invisible to the public and overlooked in discussions about budget and tax decisions. We recommend four improvements to ensure that tax credits are producing a benefit to the public that equals or exceeds the amount of uncollected taxes, and that a tax credit is the most effective vehicle with which to achieve this benefit.

1. Weigh Costs and Benefits of Tax Credits

Tax credits are as important to the overall resources of the state as revenue-producing measures. Once put in place, they reduce future revenues or provide taxpayer refunds, both of which affect the amount of funds available to support the state budget. We recommend that the legislature require that all measures introduced to create new tax credits or amend existing ones should include:

- An estimate of cost to the state associated with implementing the tax credit;
- A clear description of the public benefits the tax credit will produce; and
- The process and data that will be used to evaluate the actual benefits and costs that result from the tax credit.

This will help lawmakers decide in advance whether a tax credit, budget appropriation, or other strategy will best achieve the public purpose in question.

2. Increase Transparency and Accountability

When the state gives money to individuals and businesses through grants and contracts, the information is made public. This is not the case for taxpayers who derive substantial economic benefits from tax credits.

We recommend that the legislature impose more transparency and accountability for tax credits that provide large tax breaks and refunds to a small number of taxpayers. Legislative authorization for both existing tax credits and any created in the future should require that the following information be disclosed to the public:

- The identity of the taxpayer;
- The amount of the tax credit claimed; and
- Summary data provided by the claimant that verifies that the public good is being served.

3. Justify Refundability and Nonrefundability

Refundable tax credits like those temporarily created to help victims of flood and drought, are also the most helpful strategies to reduce taxes or provide cash aid to targeted taxpayers. Nonrefundable tax credits are most appropriate for taxpayers with larger tax liabilities and in amounts that can be used in a relatively short time frame.

The lowest income taxpayers often cannot access the full benefit of nonrefundable tax credits, because the credit is often larger than their total liability. This weakens the effectiveness of credits like the state's Earned Income Tax Credit (EITC), which is designed to lift working families up by helping them keep more of what they earned during the year in the form of a tax rebate. To maximize the impact of the EITC and other credits designed to help low-income households, Hawai'i should change its EITC from a nonrefundable credit to a refundable one.

We recommend that lawmakers consider and include in legislative language the reasons why each newly authorized tax credit is made refundable or nonrefundable. As nonrefundable tax credits may be an unexpected drain on resources even after they've expired, legislators should also consider parameters that may limit the amount and time period over which benefits may be used.

4. Index to Inflation

Many of Hawai‘i’s tax credits that promote social welfare have not been adjusted regularly to reflect inflation. Most of these tax credits are available to lower-income taxpayers, so over time fewer claimants are eligible because their wages have risen with inflation. In addition, if the dollar value of the benefit is not increased to keep up with costs, it no longer meets its intended purpose.

The tax credit for low-income renters, which was last adjusted for inflation in 1989, is a good example of this concern. If updated to 2021 dollars, income eligibility would increase from $30,000 per year to $68,100 and its value for every personal exemption would be $159 instead of $50.

We recommend that lawmakers review and update tax credits where eligibility is based on restricted incomes, and dollar amounts are intended to offer economic assistance. Once adjusted to current dollars, legislation should ensure that these tax credits are adjusted annually for inflation.

HAWAI‘I TAX CREDIT TRENDS

In 2019, Hawai‘i provided a variety of tax credits:

- Nine tax credits were intended to promote social welfare;
- 11 tax credits were to encourage certain industries or economic activities (five additional expired economic incentive tax credits were still being claimed in 2019); and
- Two tax credits were used to avoid double taxation or pyramiding Hawai‘i taxes.

Changes in Dollar Amounts and Claims by Tax Credit Category

In 2000, Hawai‘i's tax credits amounted to a total of $154 million. This figure more than doubled by 2015 when it totaled $339 million. It has since declined, totaling $310 in 2019. (**All amounts are in 2021 dollars.**)

The ebb and flow of tax credit claims and amounts over the past two decades reflects the addition and subtraction of tax credits.

- Since 2000, 15 economic incentive tax credits were added, seven of which have expired. In addition, two tax credits from previous decades were eliminated.
- In 2018, the state implemented the only notable new social welfare tax credit, the state Earned Income Tax Credit (tax credits were also added for school repair and individual development accounts, but the former accounts for little activity and the Individual Development Account tax credit was never claimed).
- No changes were made to the two tax credits to avoid double taxation and pyramiding.

The distribution of dollars by type of tax credit has also altered over the years.

- In 2000, 54 percent of tax credit dollars went to avoid duplicating and pyramiding tax payments. By 2019, they accounted for just 31 percent of all tax credits.

- Less than 20 percent of tax credit dollars in 2000 were for economic incentives. The number of economic incentive credits increased and their dollar value grew to 64 percent in 2011. By 2019, the dollar amount of these credits had again been reduced but still amounted to 41 percent of all claims paid—double the 2000 percentage.

- Tax credits for social welfare accounted for 28 percent of total tax credit dollars in 2000, but dipped to just 14 percent in 2005. By 2011, dollars for social welfare tax credits had rebounded due to changes in the food/excise tax credit. By 2019, social welfare tax credits again made up 28 percent of the total, reflecting the implementation of the Earned Income Tax Credit in 2018.

Most tax credits that promote social welfare produce a large number of claims in relatively small dollar amounts. Tax credits in other categories are usually much larger in dollar value but with fewer claims. The proportion of claims has remained generally steady but a change in the food/excise tax credit in 2007 increased social welfare claims while industry and economic incentive claims increased due to the popularity of the renewable energy tax credit starting in 2011.

Figure 1. Tax Credit Dollar Amounts, 2000–2019 (Millions/2021 Dollars)

Figure 1. The dollar values of tax credits by category have changed to reflect the addition and expiration of tax credits. Tax credits to support economic activity have increased the most over the two decades.

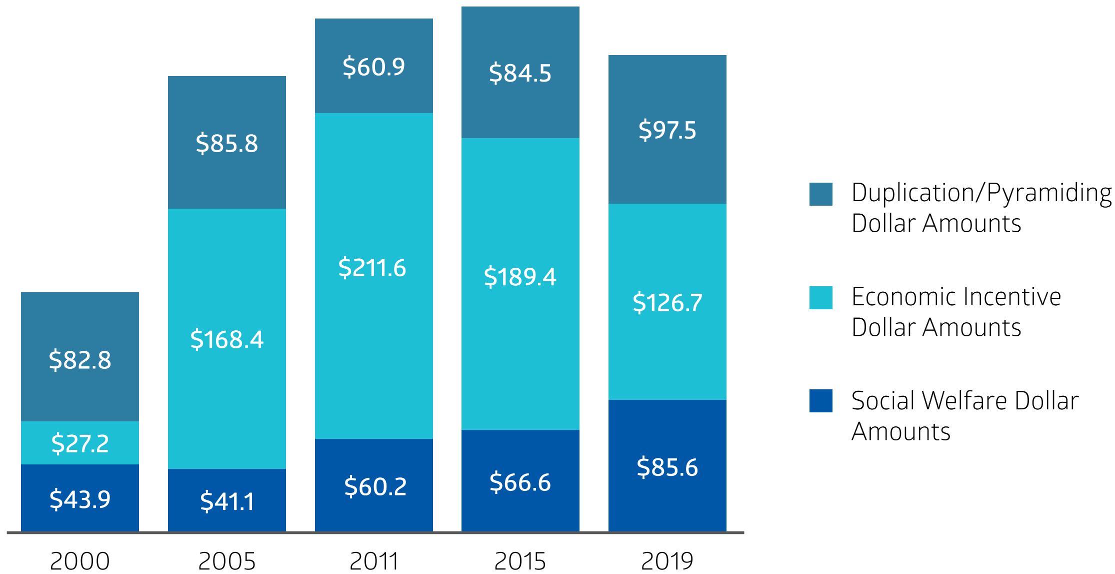
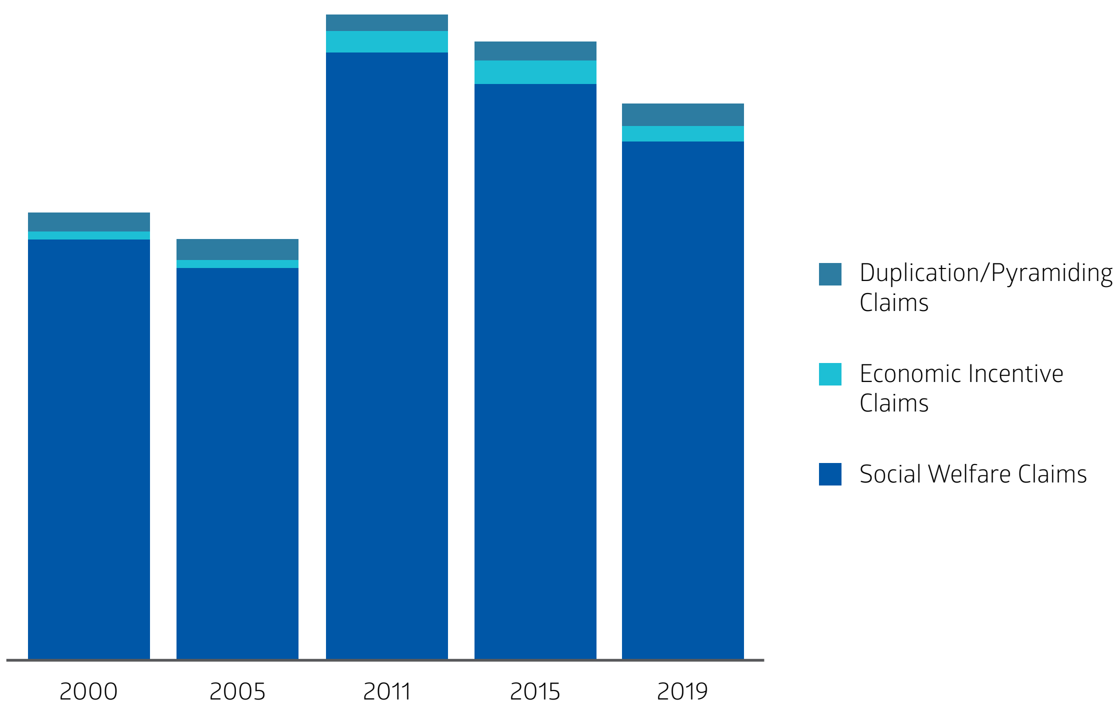


Figure 2. Tax Credit Claims, 2000–2019

Figure 2. Social welfare tax credits account for 93–95 percent of all claims filed. In contrast, industry/economic incentive and duplication/pyramiding claims each make up only 2–4 percent of the total.



In 2000, two-thirds of all tax credits were refundable. These tax credits are used in the year they're incurred, either reducing the claimants' tax liability or paid out as refunds. In 2000, the largest refundable tax credit was for food/excise tax relief. In 2019, the dollar value of the motion picture/film tax credit eclipsed other refundable credits.

By 2019, 60 percent of tax credit dollars went to nonrefundable tax credits. This reflects the fact that most tax credits created in or after 2000 were created to incentivize industries and economic activities and made nonrefundable. Two exceptions are notable: One is the significant growth since 2000 of the refundable motion picture tax credit in the economic incentive category, and the second is the creation of the nonrefundable Earned Income Tax Credit in the category of promoting social welfare.

Figure 3. Tax Credit Dollar Amounts, 2000–2019 (Millions/2021 Dollars)

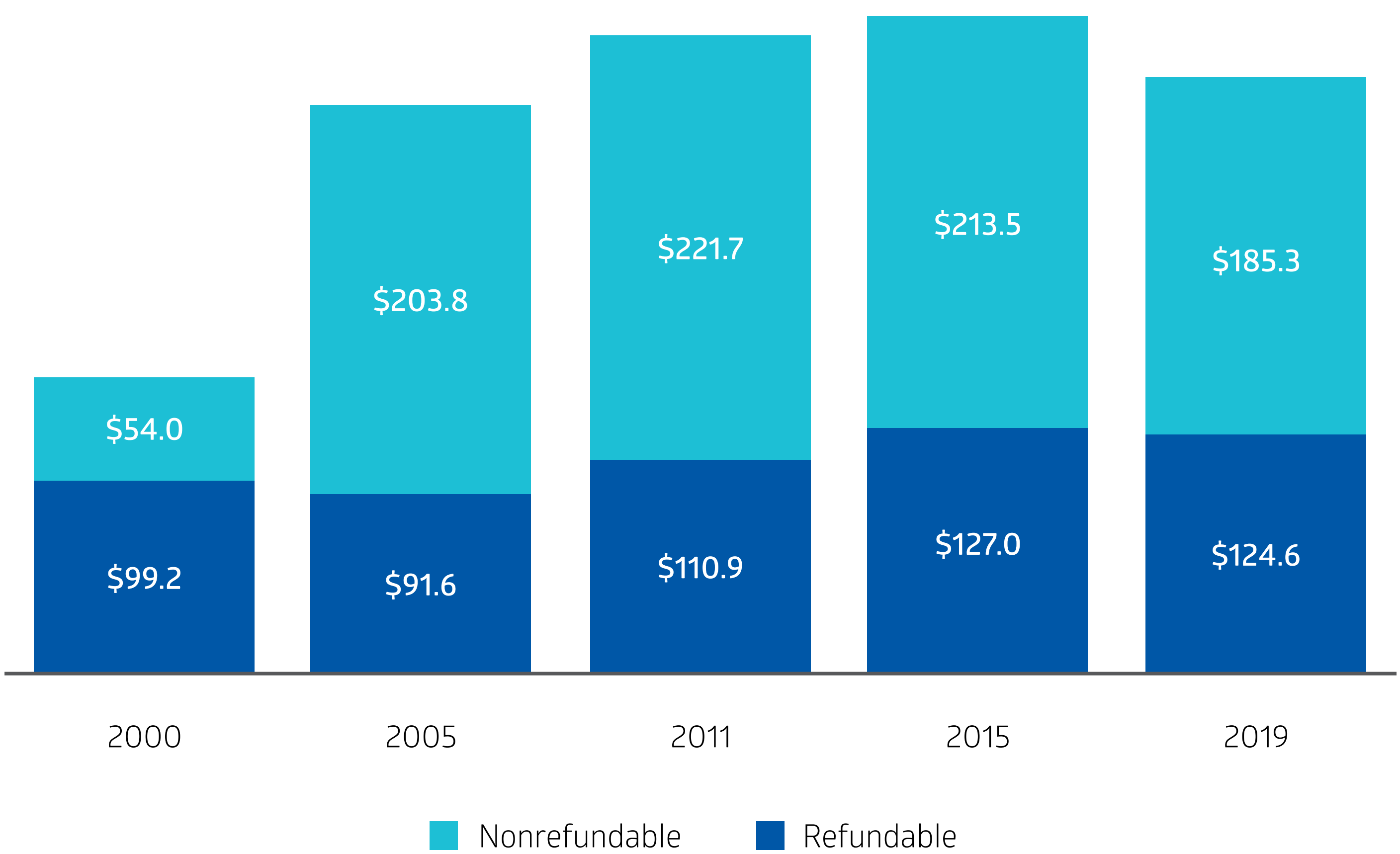


Figure 3. In 2000, 65 percent of all tax credit dollars were for refundable tax credits and 35 percent for nonrefundable. The proportion flipped by 2005, as more nonrefundable tax credits were added. In 2019, the proportion of tax credit dollars was 40 percent for refundable and 60 percent for nonrefundable.

SOCIAL WELFARE TAX CREDITS

The nine tax credits in this category directly or indirectly support low-income households or promote certain socially-desirable activities.

In 2019, more than 90 percent of these tax credits went to lower-income taxpayers to offset regressive General Excise Taxes on food purchases, to subsidize rent, and for the state's Earned Income Tax Credit (EITC). These three tax credits account for 59 percent of the dollar value of credits in this category. Other social welfare tax credits compensate for costs related to child and dependent care, incentivize the purchase of child car seats, and ensure telephone access for people with disabilities.

The Low-Income Housing Tax Credit (LIHTC), the second largest social welfare credit, largely offsets taxes for a small number of businesses. Businesses purchase these tax credits to offset their state tax liability, and the money paid is used to develop low-income housing.

For a variety of reasons, businesses have been able to purchase Hawai‘i's LIHTC at a significant discount. In fact, businesses were able to get a tax credit of nearly twice as much as they paid for low-income housing development. Legislative changes made in 2021 were intended to increase the amount collected in exchange for these tax credits.

With the exception of LIHTC, most of the tax credits in the social welfare category are refundable. One notable exception is the state EITC, effective in 2018. Although the aim of Hawai‘i's EITC is to assist the lowest-income households, it fails to fully achieve this end because a nonrefundable tax credit is of little use to households that have little or no tax liability.

The EITC is one of just three new social welfare tax credits established by the legislature since 2000. The second is a modest tax credit available to contractors who voluntarily make repairs to public schools that was passed in 2001. The third is an Individual Development Account tax credit intended to encourage low-income taxpayers to save for long-term goals like college tuition or a home purchase. This credit was in effect from 2000 to 2004 but was never claimed.

Changes Over Time for Social Welfare Tax Credits

The long-standing social welfare tax credits—food/excise, low-income renters and dependent care—have all declined in total inflation-adjusted dollars and number of claims since 2011. This is likely because tax credit eligibility and amounts have not been indexed to inflation. For instance, the tax credits for food/excise tax and for dependent care expenses were updated most recently in 2015 and 2016, respectively.

However, the low-income renters tax credit has not been amended since 1989. If adjusted to 2021 dollars, income eligibility for this credit would rise from $30,000 per year to $68,100 and its value for every personal exemption would be $159 instead of $50.

Because of the erosion in eligibility and value due to inflation, the number of claims for the low-income renters credit fell from 47,444 in 2011 to just 20,530 in 2019.

Figure 4. Social Welfare Tax Credits Total Claims & Dollars, 2011–19 (2021 Dollars)

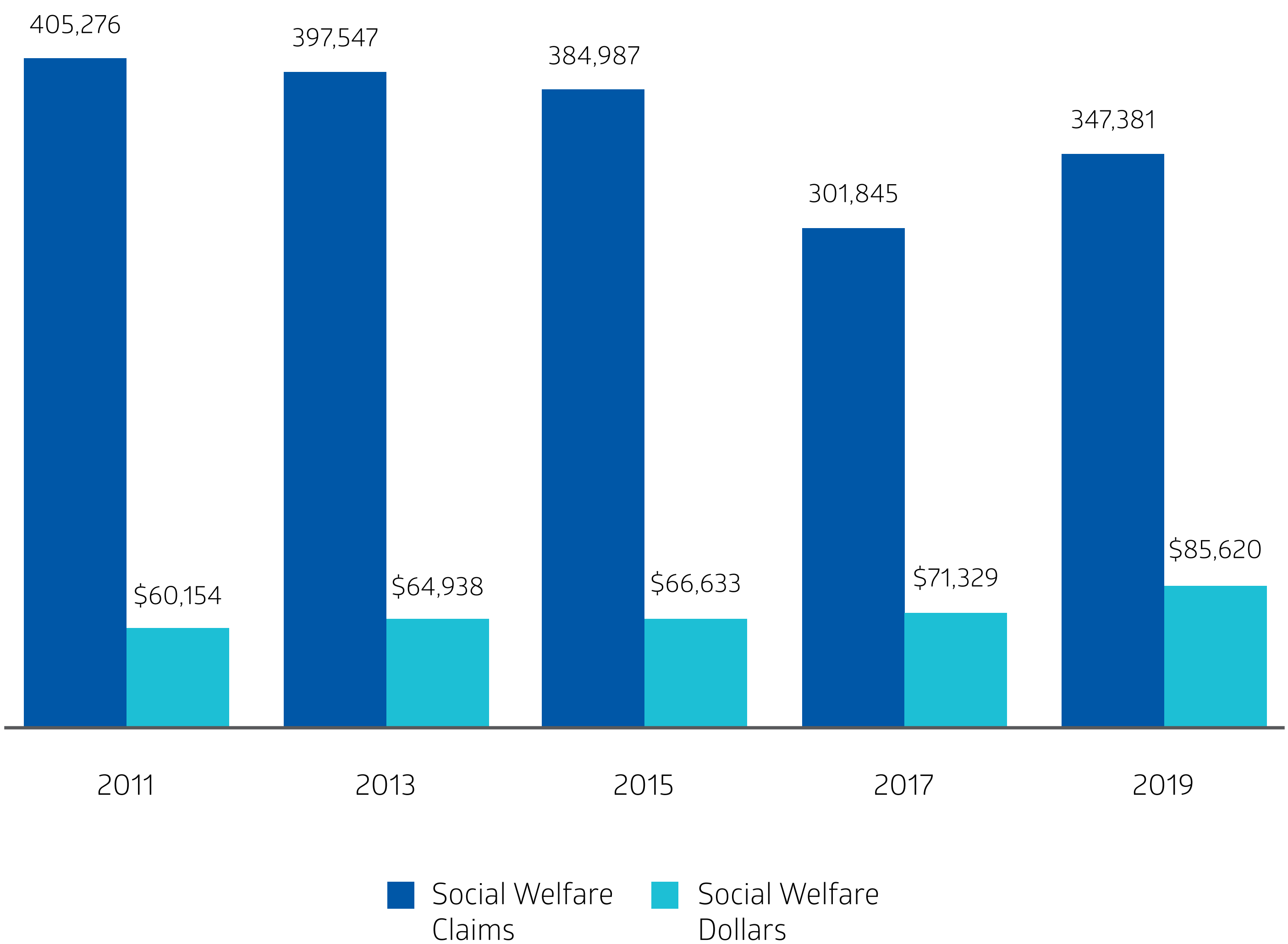


Figure 4. More than 90 percent of claims for social welfare tax credits go to low-income households for General Excise Taxes on food, for low-income renters and, starting in 2018, for the EITC. Despite the new EITC, the number of tax credits claimed by low-income households decreased by nearly 53,000 between 2011 and 2019, due largely to the failure to adjust eligibility levels for inflation.

Much of the increase in dollars paid (adjusted for inflation) can be attributed to increases in Low-Income Housing Tax Credits (LIHTC), which offset business income taxes. (Changes in dollar amounts and claims paid between 2000 and 2019 can be seen in Figures 1 and 2.)

Figure 5. Social Welfare Tax Credits, Change in Number of Claims Filed, 2011–19

Figure 5. Claims for food/excise, renters and dependent care credits were 118,509 fewer in 2019 than 2011. Even with the addition of the EITC, which was not available until 2018, the overall number of claims for social welfare tax credits decreased by nearly 58,000. This trend is likely due to the erosion in eligibility and value since these tax credits are not automatically increased for inflation.

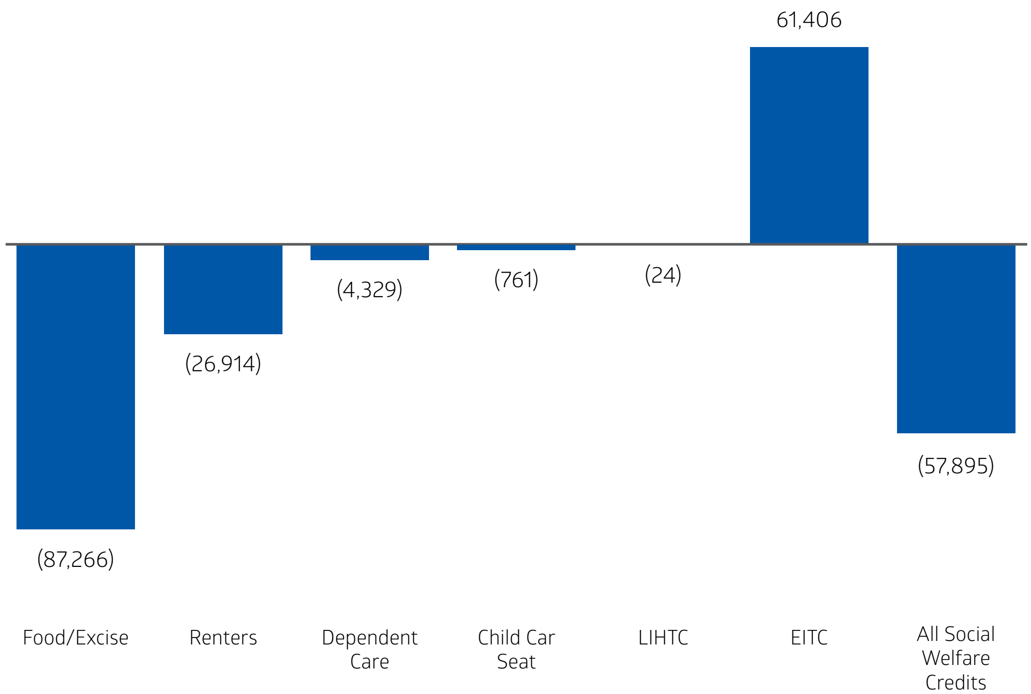
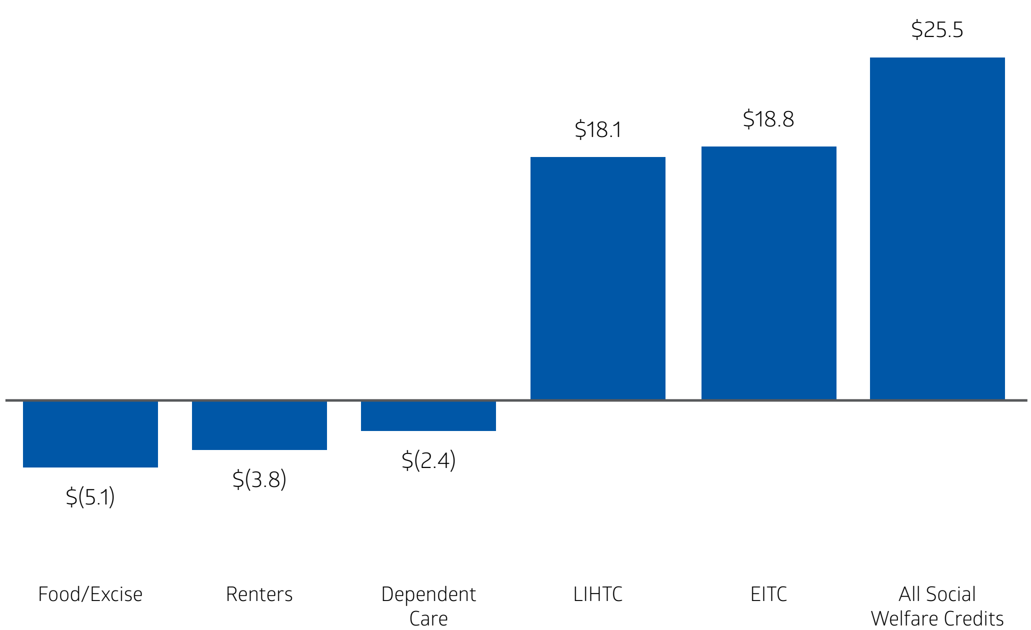


Figure 6. Social Welfare Tax Credits, Amounts Claimed, 2011 vs 2019 (Millions/2021 Dollars)

Figure 6. The dollar value claimed for the three social welfare tax credits that were most frequently claimed by individual taxpayers in 2011 declined by $11.3 million between 2011 and 2019. Both LIHTC, a tax credit claimed by a small number of businesses that invest in housing development, and the EITC, new in 2018, added to the overall dollars available for social welfare tax credits.



TAX CREDITS TO ENCOURAGE ECONOMIC ACTIVITY

This category has 11 tax credits that are claimed by both individuals and businesses. Unlike tax credits to promote social welfare, the legislature has more frequently added, changed and eliminated tax credits intended to encourage economic activities.

Eight new credits have been established since 2000 while nine have expired.

The largest tax credit in the economic incentive category, both in dollar amount ($62.5 million in 2021 dollars) and number of claims (9,036 in 2019), is for renewable energy. It is available to both individuals and businesses to offset the cost of installing photovoltaic and other energy-saving devices. While it is still the largest tax credit in this category, it has declined significantly in both the number of claims and the overall dollar since 2011.

The second largest economic incentive tax credit supports production of motion pictures and films. While its dollar value increased from $30.8 to $40.3 million from 2011–2019 (in 2021 dollars), the number of claims, always small, was only 25 in 2019.

Although it expired in 2010, the High Technology Business Investment Tax Credit is Hawai‘i's third largest economic incentive tax credit. This tax credit cost the state $1.7 billion between 2001 and 2010 but yielded little tangible economic benefit.

In fact, because this credit can be carried forward by taxpayers who claimed it before it expired, it can be used in future years. That's why in 2019 it was still used by 231 taxpayers at a cost of $13.3 million dollars.

Changes Over Time for Economic Activity Tax Credits

Between 2000 and 2019, the state added eight new economic incentive tax credits and eliminated 10. Even though some expired tax credits are still being claimed, the dollar and claims trends reflect the overall reduction in these tax credits. Only five of the 11 economic incentive tax credits were continuously available between 2011 and 2019.

Eight current tax credits were added since 2000:

1. Healthcare Preceptor (2019)
2. Organic Food Production (2017)
3. Renewable Fuels Production (2017)
4. Cesspool Upgrade and Conversion (2016)
5. Capital Infrastructure/Kapālama Relocation (2014)
6. Important Agricultural Lands (2008)
7. Renewable Energy (2003)
8. Research Activity (implemented in 2000, paused in 2011 and 2012, reestablished in 2013)

In addition to the eight current tax credits added over the past two decades, three others have been in effect since before 2000:

1. Fuel Tax Credit for Commercial Fishers (1980)
2. Enterprise Zone (1986)
3. Motion Picture, Digital Media, Film (1997)

Seven tax credits were both added and eliminated since 2000:

1. Temporary Credit for Flood Victims (added and expired in 2006)
2. Ko‘olina Development (added 2005, expired 2009)
3. Ethanol Investment Facility (added in 2002, expired 2016)
4. Residential Remodeling (added 2001, expired 2003)
5. Drought Mitigation (added 2001, expired 2005)
6. Technology Infrastructure (added 2001, expired 2010)
7. High Technology Business Investment (added 2000, expired 2010)

Two tax credits expired that were created before 2000:

1. Hotel Construction and Remodeling (added 1997, expired 2004)
2. Energy Conservation (added 1975, expired 2003)

Figure 7. Economic Incentive Tax Credits, Total Claims and Dollars, 2011–19 (2021 Dollars)

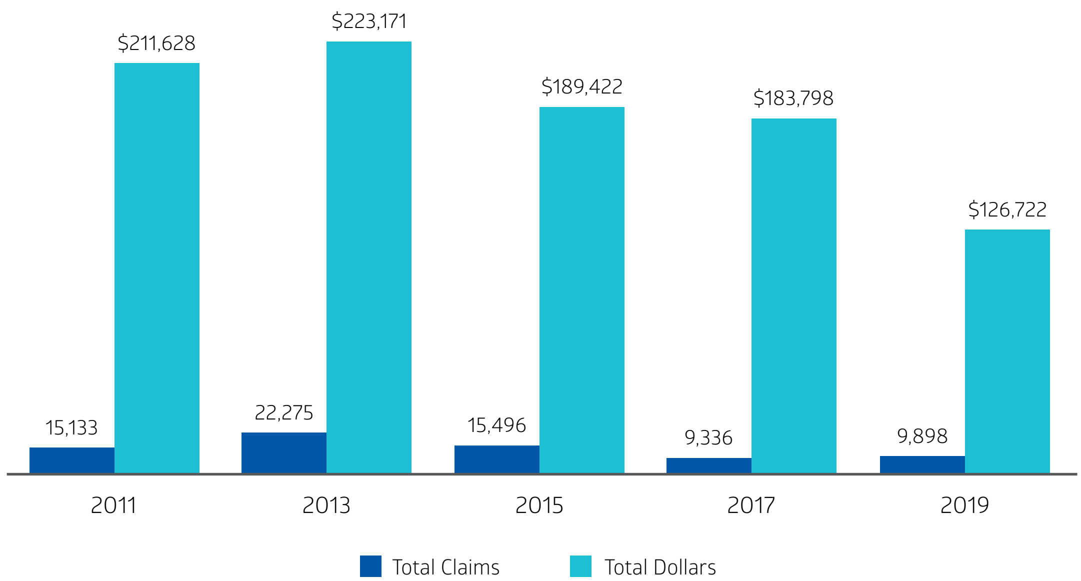


Figure 7. This figure shows payments and claims for all economic incentive tax credits, including those that were expired in the year claimed. The overall dollar value of economic incentive tax credits (in 2021 dollars) was at a high in 2013. This total was reduced by 43 percent by 2019. The total number of claims are down by 56 percent from 2013.

Figure 8. Economic Incentive Tax Credits, Change in Dollar Amounts Claimed, 2011–19 (Millions/2021 Dollars)

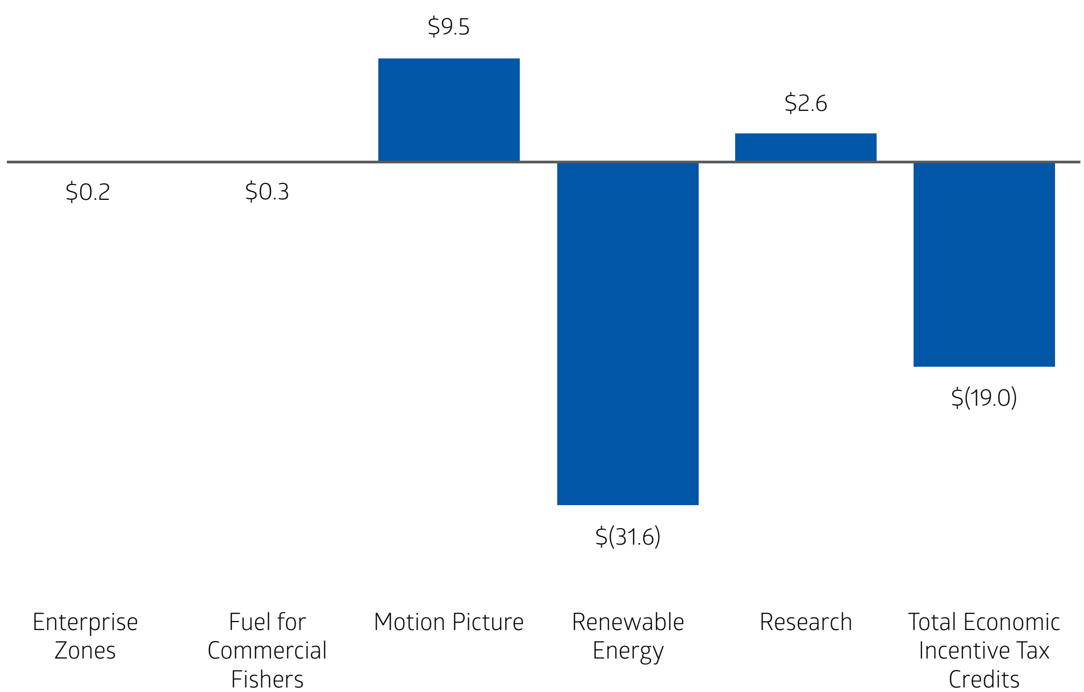


Figure 8. Four of the five economic incentive tax credits that were available between 2011 and 2019 have seen increases, most notably the tax credit for motion picture and film production. However, the overall dollar value of claims for them has decreased. This is because the renewable energy tax credit, the largest of all tax credits, has declined significantly.

TAX CREDITS TO AVOID PYRAMIDING OF HAWAI‘I TAXES

Two tax credits are in this category: one is available to taxpayers filing Hawai‘i returns who have earned and paid taxes on income in another state or country, while the other is aimed at avoiding General Excise Tax (GET) "pyramiding." That means it reduces the application of the GET at every level of production, which would otherwise add substantially to the cost of goods or services.

Figure 9. Tax Credits to Avoid Double Tax/Pyramiding, 2011–19 (Millions/2021 Dollars)

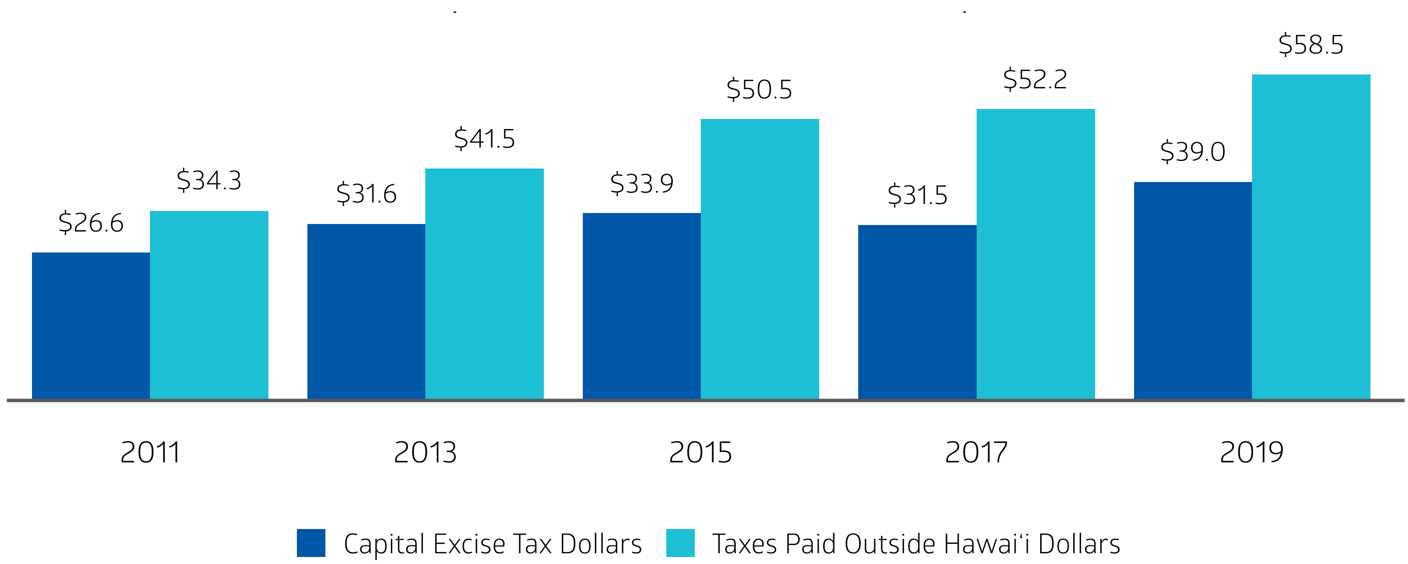


Figure 10. Tax Credits to Avoid Double Tax/Pyramiding, 2011–19, Number of Claims

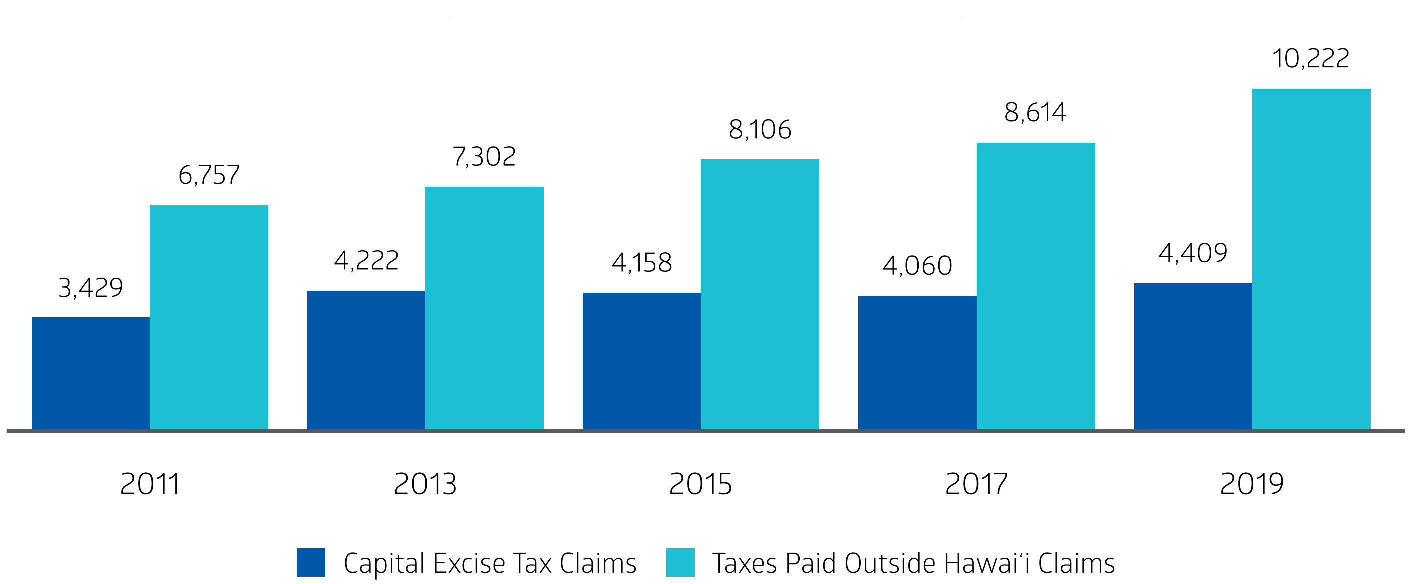


Figure 9 & 10. Total tax credit claims and dollar amounts for taxes paid outside of Hawai'i have increased steadily since 2011. Tax credit claims for capital excise tax generally increased more modestly in dollar amounts and number since 2011, with a dip in both in 2017. (Dollar figures are adjusted for inflation.)

EXPIRED TAX CREDITS

Tax credits may be eliminated if the legislature determines they no longer offer sufficient value or come at too high a cost. However, even after they expire, payouts can linger for years since nonrefundable tax credits can usually be carried over until fully exhausted.

The most notable tax credit in this category is the High Technology Business Investment Tax Credit, which offered a generous multi-year tax credit. Although it expired at the end of 2010, it was still being claimed by 231 taxpayers in 2019 for a total amount of $13.3 million. It accounts for most of the expired tax credit dollars claimed since 2011.

Two other expired tax credits were claimed in 2019: The technology infrastructure renovation tax credits (expired 2010) still provided $11,000 in tax breaks to six taxpayers, and 25 taxpayers reduced their taxes by $75,000 with the residential construction and remodeling tax credit (expired 2003).

Figure 11. Value of Expired Tax Credits, 2011–19 (Millions/2021 Dollars)

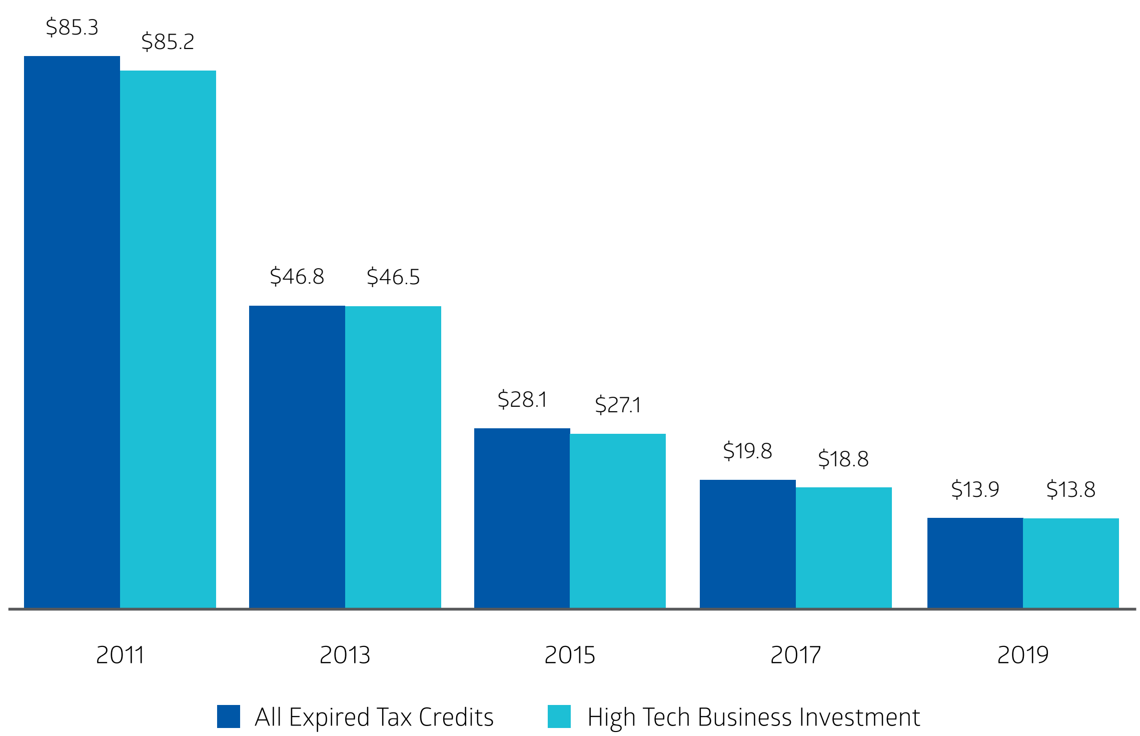


Figure 11. Most of the expired tax credits dollar amounts claimed since 2011 have been for the High Technology Business Investment Tax Credit.

DISTRIBUTION OF TAX CREDITS IN 2019

With a few exceptions, tax credits intended to promote social welfare are relatively small in dollar amount but widely distributed. Conversely, tax credits intended to promote economic activity benefit a smaller number of taxpayers but in larger dollar amounts.

The per-credit amounts claimed for tax payments to other jurisdictions and tax credits that reduce pyramiding of general excise taxes on capital expenditures are also relatively large. Figures 11–16 illustrate differences in tax credits according to the number and kind of filers, and the amounts distributed overall and per taxpayer claim.

Figure 12. Average Dollar Value Per Tax Credit Claim, 2019

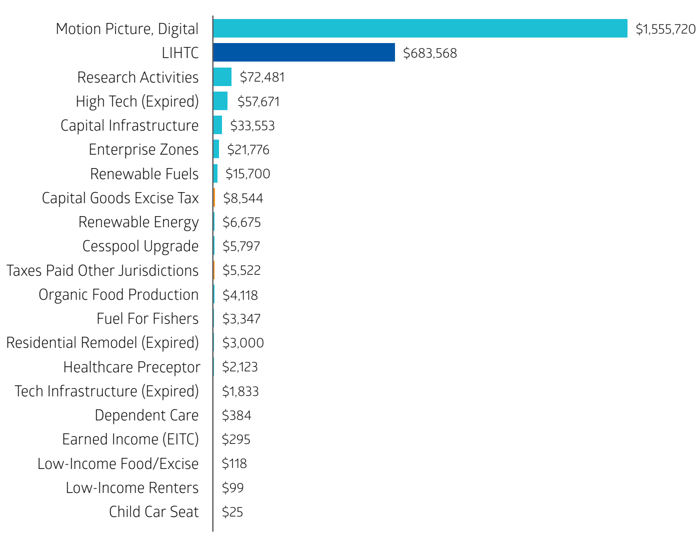


Figure 13. Number of Taxpayers Claiming by Category, 2019

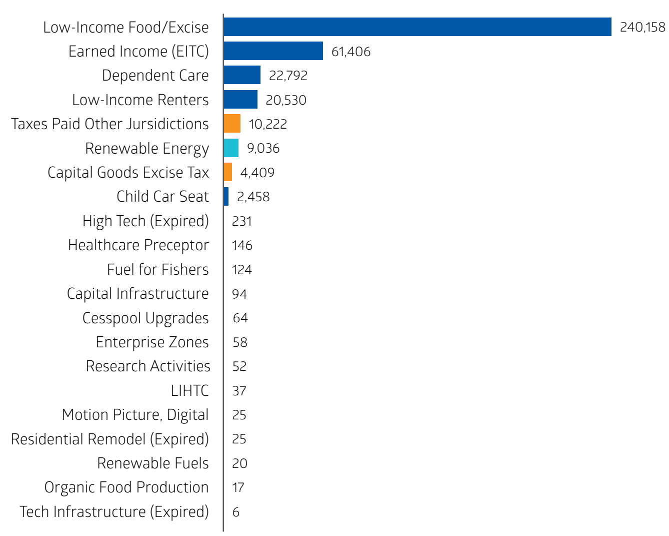


Figure 12 & 13. The 10 tax credits that provide the largest average dollar amount per credit account for 5 percent of all claims filed. Eight of these 10 promote economic activities. Conversely, the four tax credits claimed most often account for 93 percent of all credits and are all intended to promote social welfare. Social welfare tax credits are shown in dark blue, economic incentive tax credits are shown in light blue, and tax credits to avoid pyramiding and double taxation are shown in orange.

Hawai‘i's individual income tax system is progressive in that low-income taxpayers pay lower overall rates than higher income taxpayers. Tax credits that support social welfare enhance the progressivity of the tax system by reducing income tax liability and even refunding money to numerous low-income taxpayers in small amounts. Tax credits that incentivize economic activity have the opposite effect in that the most affluent individual taxpayers are most able to reduce their tax liability with few but larger claims.

Figure 14. Number of Individual Taxpayer Claims by Income, 2019

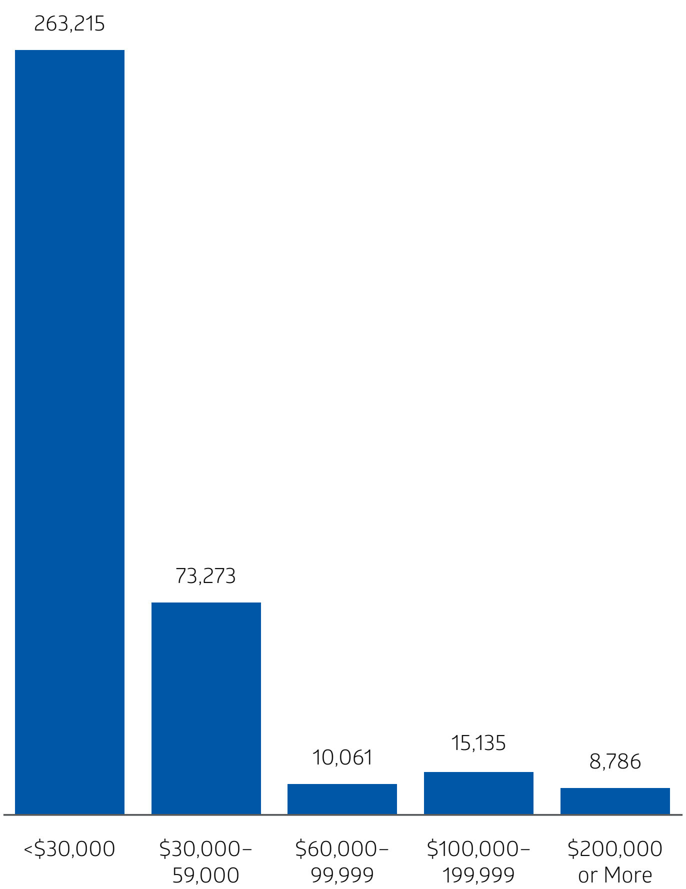


Figure 15. Average Credit Amount per Individual Taxpayer Claim by Income, 2019

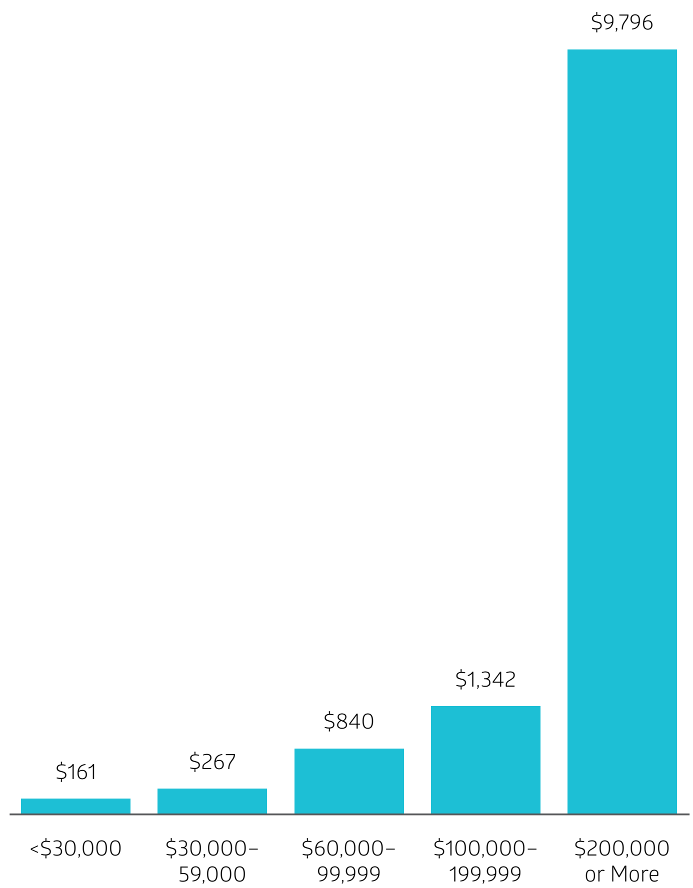


Figure 14 & 15. Lower-income taxpayers generally receive small tax credit amounts intended to increase economic security. High-income taxpayers, however, are able to claim larger tax credit amounts for promoting economic activity and reducing duplication/pyramiding of taxes. As a result, taxpayers with incomes of less than $60,000 per year filed 91 percent of all tax credit claims and received 35 percent of tax credit dollars paid to individuals. Those with incomes of $200,000 or more, filed 2 percent of all claims but got 49 percent of tax credit dollars paid to individuals.

Figure 16. Total Tax Liability Compared with Tax Credits by Taxpayer Type (Millions/2021 Dollars)

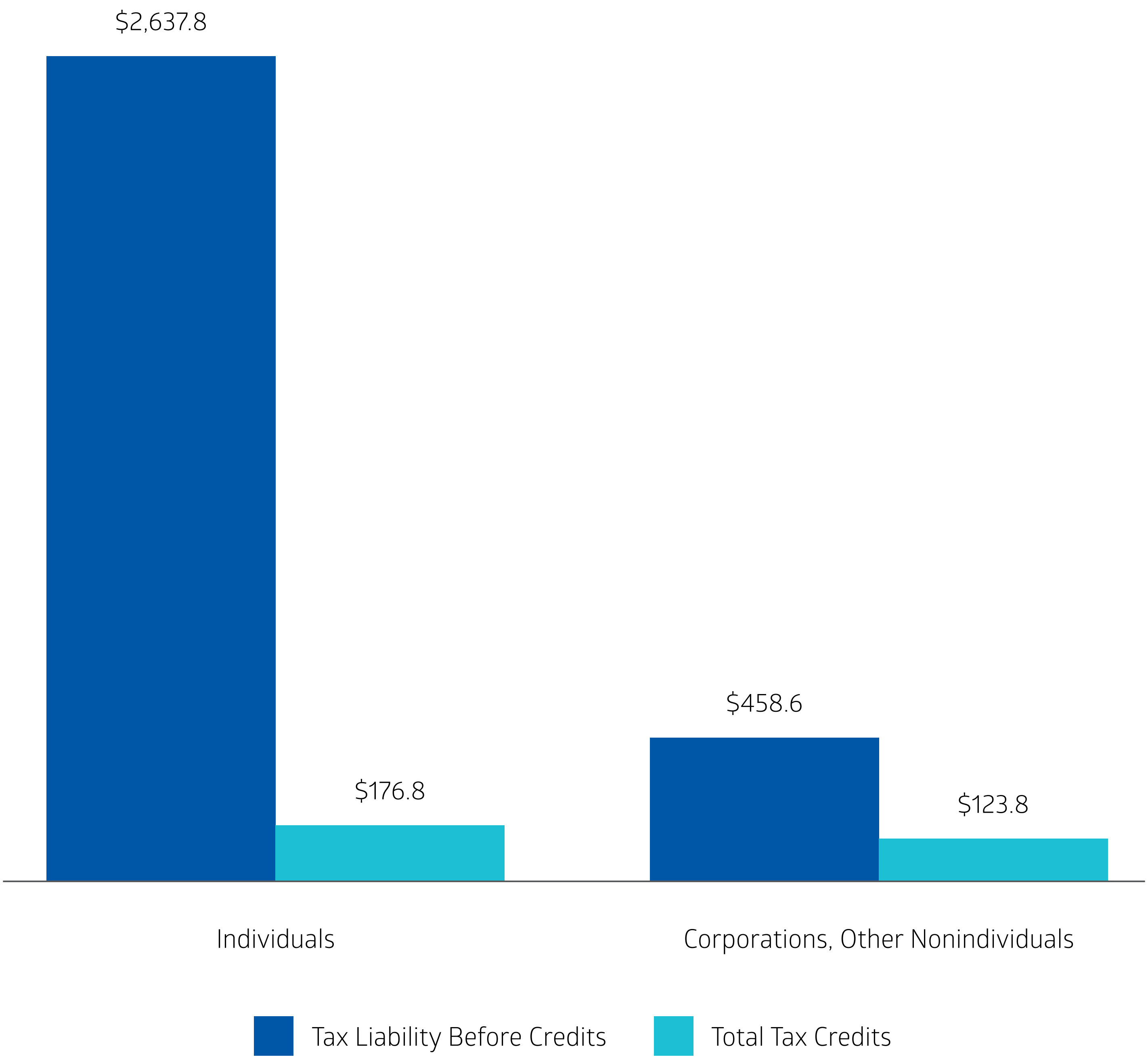


Figure 16. In 2019, corporations, financial corporations, insurance underwriters and other non-individual taxpayers contributed only 4 percent of Hawai'i's $8.3 billion in total tax revenues while individual taxpayers paid 31 percent of that amount. Tax credits disproportionately reduce the tax liability of corporations and other non-individual taxpayers, subtracting 27 percent from amounts owed. Tax credits reduced individual income tax liability by just 7 percent.