

Public Policy

Cutting Taxes to Strengthen the Economy and Boost Hawai'i's Families: A Refundable State Earned Income Tax Credit

EXECUTIVE SUMMARY

Building a stronger Hawai'i for businesses and residents means creating more opportunities for working families to climb the economic ladder. The Earned Income Tax Credit (EITC) is a proven tool for fostering economic prosperity.

The federal EITC is a tax credit that reduces or eliminates workers' tax liability. It has been praised as the most effective anti-poverty program in the U.S.; has been endorsed by every president since Richard Nixon; and continues to receive broad, bi-partisan national support.¹

Twenty-six states and the District of Columbia offer a state EITC to help families keep more of their earnings. The credit has been championed by families and businesses alike in these states because it gives a much-needed break to working families struggling to get by on low wages, and boosts local economies across the state. **Now is the time for Hawai'i to invest in its residents and businesses by creating a state refundable EITC that puts dollars back into workers' pockets and into the cash registers of local business.**

The EITC helps struggling families. Working families in Hawai'i have seen their purchasing power shrink over the years. High rents, stagnant wages, and increasing energy and food costs mean a family's dollar has to stretch further every year just to meet basic needs. A state EITC would put thousands of dollars back into the pockets of working residents with far-reaching benefits for both parents and children.

The EITC helps local businesses. When working families struggle, businesses suffer. By helping workers keep more of their hard-earned wages, the EITC directly benefits local businesses through increased consumer spending. Additionally, encouraging more financially stable families indirectly supports local businesses in the form of more reliable employees with strong incentives to work more.

The EITC is an efficient tool for helping working families. The EITC is the most effective anti-poverty program in America because it targets working families in need and efficiently delivers support through tax refunds, a process that requires minimal administrative costs.

A state refundable EITC is an affordable, targeted reform that encourages work and strengthens local economies. Hawai'i's legislators should adopt the policy for the benefit of our businesses and working families.





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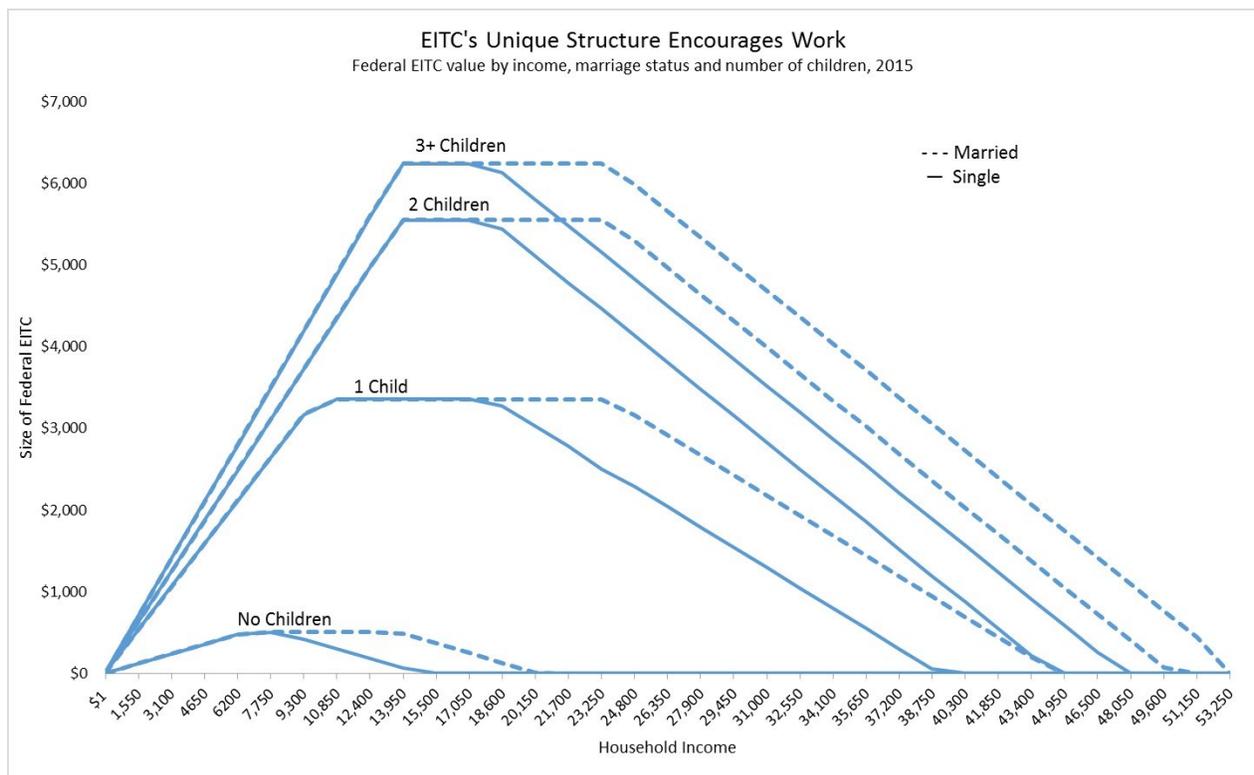
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WHAT IS THE EITC?

The Earned Income Tax Credit is a federal tax credit that helps families work their way into the middle class. Since its inception in 1975, the federal EITC has been hailed as *the most effective anti-poverty program in the U.S.*, improving the futures of low- and moderate-income workers and that of their communities.²

The EITC is only available to people who earn income through low-wage work, most of them raising children. It helps families who, despite working, are still unable to make ends meet and who do not qualify for other programs. The federal credit is refundable, meaning that if a family's credit is greater than their tax liability, the remaining portion of the credit is returned to the family.

The unique structure of the EITC ensures that those most in need receive the most benefit. The size of the credit depends on a family's filing status, number of dependent children, and income. As a family earns more, the credit grows, levels off, and eventually phases out as the family's need decreases. The largest credits go to families who earn between roughly \$12,000 and \$18,000 for single filers and \$12,000 and \$24,000 for married filers. However, families earning between roughly \$46,000 and \$52,000 can still receive the credit, allowing the EITC to reach moderate-income families.



THE EITC IS GOOD FOR FAMILIES

The EITC gives a much-deserved break to people who work but still struggle to get by in Hawai'i's high-cost environment. It lets low- and moderate-income working families keep more of what they earn to help pay for basic necessities like groceries, childcare, and transportation.

Families in Hawai'i have seen their dollars' purchasing power shrink over the years. The costs for basic necessities have dramatically risen while wages have seen only a slight increase. In fact, when adjusted for the cost of living, Hawai'i's wages are the second lowest in the nation. Housing costs, which are among the highest in the nation, are a large part of the equation.³ A worker would have to earn \$31.54 an hour to afford a two-bedroom apartment but the average hourly wage of a renter is \$14.49.⁴ With no signs of this trend stopping, families need to be able to keep more of what they earn.

Despite being limited to working households with modest incomes, the EITC reaches a large number of Hawai'i's families. In 2013, the federal credit put an estimated \$238 million back into the pockets of Hawai'i residents and economy, providing each recipient with an average of \$2,175.⁵ As the table below shows, every county benefitted from the credit.

County	Total EITC Claimed
Honolulu	\$159,358,840
Hawai'i	\$40,158,399
Maui	\$26,738,953
Kauai	\$11,460,678
Kalawao	\$10,266
Total:	\$237,727,136

Around 110,000 households in Hawai'i claimed the EITC in 2013.⁶ Those households consisted of an estimated 315,800 Hawai'i residents in total, including nearly 127,200 children.⁷ More than 14,000 veterans and military families received the federal EITC in 2012.⁸ Each year from 2011 to 2013, it lifted an average of 36,000 Hawai'i residents, including 18,000 children, out of poverty.⁹

THE EITC IS GOOD FOR FAMILIES

It's good for parents...

The EITC incentivizes work because it allows families to keep more of what they earn. This not only increases household earnings, but also reduces the need for public assistance. For families with very low wages, the credit increases with each dollar earned, which encourages them to work more hours. This helps struggling families get a firmer foothold in the workforce and to be more resilient in the face of temporary setbacks like pay reductions, or layoffs. For families working their way into the middle class, this helps prevent minor hiccups from becoming major setbacks.

It's good for children...

In 2013, the EITC kept 6.2 million people out of poverty nationally. More than half of those were children. In fact, the number of children living in poverty would be 25 percent higher without the EITC.¹⁰

The benefits of the EITC are immediate and long lasting. Children and young adults in families receiving the federal and state EITC experience financial, educational and health benefits that strengthen their foundations for future success.

Children in families who receive a credit that's worth around \$3,000 during a child's early years can see their school performance boosted by about the equivalent of two extra months of school and the EITC is linked to higher test scores, especially in math, for low-income students in elementary and middle-school.¹¹ The educational benefits continue into college for children whose families received the credit. This group has higher high school graduation rates and college enrollments.¹²

Children also see increased earnings as a result of their parents receiving the EITC. Children in families who receive a credit worth \$3,000 before the age of 6, work an average of 135 more hours a year between ages 25 and 37 and their annual earnings increase by 17 percent.¹³

The EITC is linked to healthier moms and babies. Not only is it been associated with increased birth weight for newborns, but also self-reported improvements in maternal health.¹⁴

Over 127,000 children in Hawai'i would benefit from increased financial stability if the state adopted an EITC.¹⁵ Young children in families with enough income to cover basic necessities—like going to the doctor when they are sick and breakfast before they go to school—do better and go further in school.¹⁶ This stronger start in life and in school puts them on a better path that continues even once they are grown. Not surprisingly, young children in low-income families that get a boost from the EITC end up working and earning more when they become adults.¹⁷

THE EITC IS GOOD FOR BUSINESS

In addition to providing far-reaching benefits for Hawai'i's families, the EITC is also a boon to local businesses. When families keep more of their earnings it increases the amount of money these families have to spend at local businesses. Every \$1 received from the EITC generates an estimated \$1.50–\$2.00 in local economic activity.¹⁸

It's good for employers...

The EITC benefits employers because workers who can pay for basic necessities are more dependable employees than those who struggle financially. Workers can spend the credit on childcare for their kids and reliable transportation to get to work, helping them to become successful employees.¹⁹

In addition, as much as 36 cents of every dollar of EITC ultimately flows to employers.²⁰ When workers keep more of what they earn, they put some of those dollars back into the economy when they make purchases. The rounds of spending and re-spending have a direct impact of businesses and their production, employment, and income. Businesses can hire more workers and increase their profits.²¹

It would support Hawai'i's small businesses...

A state refundable EITC set at 10 percent of the federal credit would infuse close to \$24 million into our local economy. Hawai'i's small businesses employ over half of the state's private workforce, and with a slower economic recovery than the rest of the United States, small businesses need a boost.²² Workers who receive the credit spend it at local businesses to buy school supplies for their children or pay for car repairs.²³

A state EITC not only provides immediate benefits to working families, but is also a major investment in Hawai'i's economy.

The EITC is a smart tool for supporting families and incentivizing work....

The EITC provides a myriad of benefits while minimizing administrative burdens. At the federal level, EITC administrative costs are less than 1 percent of the benefits paid out while other non-tax benefits have administrative costs as high as 20 percent of program expenditures.²⁴ The same holds true for a state EITC—integrating the credit into our state tax filings couldn't be simpler.²⁵

THE EITC IS GOOD FOR BUSINESS

In addition, the EITC goes only to people who earn income through low-wage work and file a tax return. The credit is structured so that as a family's earnings grow over time, the credit begins to phase out at modest income levels. This prevents families from feeling the "cliff effect" or having a sudden drop off in benefits, which can set families back. Families are able to keep the gains they've made and most families only claim the credit for one or two years at a time. The EITC acts as a "short term safety net," helping families during periods of economic shocks, such as when a child is born or a spouse loses their job.²⁶

Hawai'i Should Build on the Federal EITC's Success

Twenty-six states and the District of Columbia have boosted the impact of the federal EITC by enacting a state version. The state credits build on the success of the federal credit, helping workers make ends meet and expanding the credit's well-documented long-term positive effects. Generally, state EITCs are calculated as a percentage of the federal credit, ranging from 3.5 percent in Louisiana to 40 percent in Washington, D.C. For example, in a state with a 10 percent EITC, a family with a \$5,000 federal credit would receive a \$500 state credit.

For low- and moderate-wage workers in Hawai'i, that state credit would help reduce or eliminate their state taxes. Approximately 11,000 households in Hawai'i would have their state income taxes reduced to zero or less with a 10 percent refundable state credit, while many other households would see their taxes reduced.²⁷

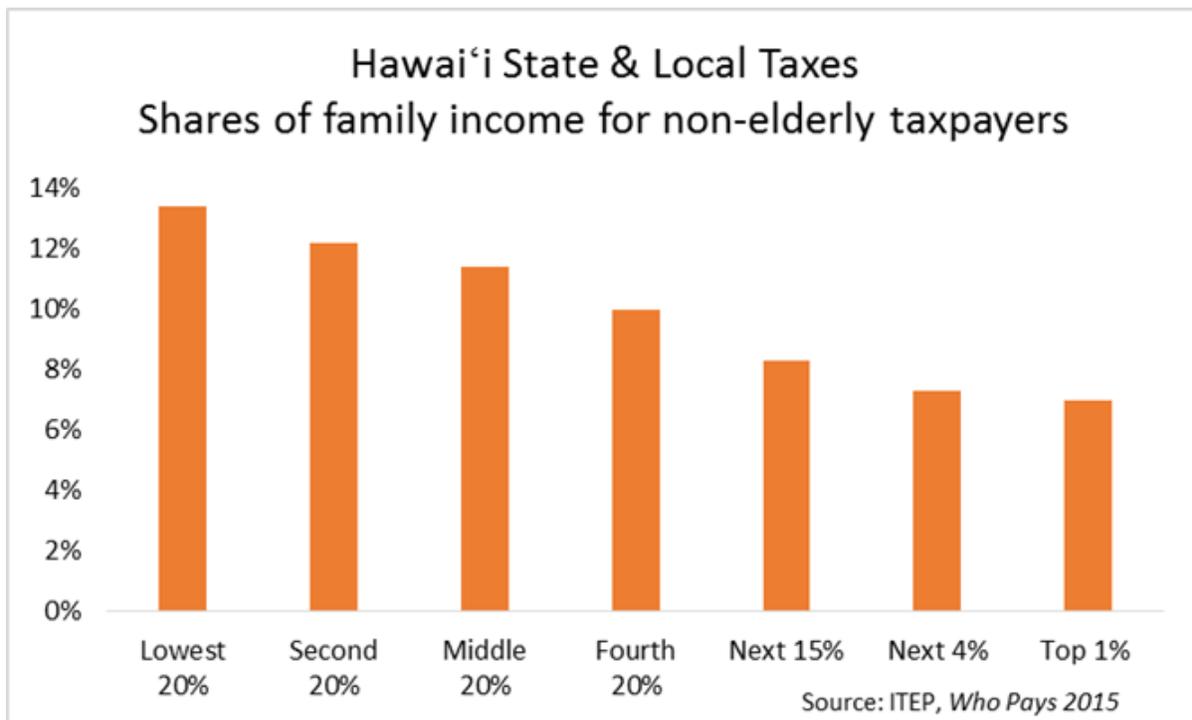
A new state EITC in Hawai'i would be a modest investment that has strong and lasting returns. **A 10 percent refundable EITC would put almost \$24 million back into the pockets of an estimated 108,000 hard-working families** and increase spending in the local economy.

AN EITC CUTS TAXES FOR THOSE WHO NEED IT MOST

It would cut taxes for those who need it most...

Hawai'i is the second worst state in the nation in terms of taxing people in poverty. The lowest earners pay almost twice as much as the wealthiest, primarily because of the general excise tax—the bottom 20% of earners pay 13% of their income in taxes, while those in the top 1% pay just 7%.²⁸ A refundable state EITC would help correct this imbalance and let working families keep more of what they earn so they can better afford Hawai'i's high cost of living.

A Hawai'i EITC would amount to a tax cut for people who need it most: workers in low wage-jobs and their families striving towards the middle class. The EITC cuts taxes from the bottom up, allowing those who earn the least to keep more of their income. Unlike cutting tax rates, which disproportionately cuts taxes for the wealthy and barely reduces the tax burden for the poorest families, the EITC is able to target working low- and moderate-income families.



Consider three hypothetical cases of families in Hawai'i that would benefit from a state EITC. These examples assume that Hawai'i lawmakers set the EITC at 10 percent of the federal credit, a modest and affordable goal.²⁹

AN EITC CUTS TAXES FOR THOSE WHO NEED IT MOST

One Parent, One Child

A single parent of one, working full-time and earning the minimum wage, earns \$14,500 annually before taxes, and would owe Hawai'i about \$94 in taxes.

A refundable state EITC set at 10 percent of the federal credit would amount to \$330. They would receive a refund of \$236. The state credit eliminates the tax liability and the refund helps to put money spent on other taxes, like the general excise tax on everyday purchases, back into their pocket.



Married Couple, Two Children

A young couple with two children earns a combined income of \$29,000 and would owe \$582 in taxes. A 10 percent refundable state credit would reduce their tax liability by over \$400, down to just \$158.

For this couple, just beginning their economic mobility journey, the reduced tax liability allows them to save and spend their money in ways that benefit their family and Hawai'i's economy. They can use that money to help pay for child care, transportation, or to build savings.



Married Couple, Three Children

A married couple with three children earns a combined income of \$40,000, owing \$1,258 in taxes.

Their new tax liability after applying a 10 percent refundable EITC is \$997. They are on their way to the middle class, so the credit has begun to phase out for them. It still plays an important role in relieving a portion of their tax liability, which allows them to continue on their path up the economic ladder.



NEW REVENUE SOURCES

Hawai'i can Afford a State EITC

A ten-percent Hawai'i state Earned Income Tax Credit will cost the state just under **\$24 million**. Hawai'i has several ways to generate the revenue necessary to pay for this important investment for Hawai'i's economy and struggling working families. In particular, we recommend seven potential tax policy modifications, any one of which could help fund a state EITC and improve the overall fairness of Hawaii's tax structure.³⁰

1

Eliminate the Property Tax Deduction - Under almost any measure, Hawai'i has one of the lowest property tax rates in the nation.³¹ In addition to these low rates, Hawai'i follows the federal treatment of income by allowing a deduction for property taxes paid. Only those taxpayers who itemize deductions are able to benefit from the property tax deduction. Meanwhile, property taxes are passed along to renters in the form of higher rents, but they do not receive a similar tax write-off. Simply removing the property tax deduction would generate **\$27.2 million** in new revenue.³²

2

Eliminate the State Income Tax Deduction - Hawai'i is one of only seven states in the U.S. that allows taxpayers to deduct state income taxes they have paid during the course of a year when calculating their final state income tax bill for that same year.³³ This deduction is little more than an error in the tax code imported through an inartful copying of the federal tax system, which allows the deduction of state income taxes paid. Hawai'i's failure to require itemizers to add back the deduction has been criticized by tax and budget experts as "irrational," "nonsensical," and "poor tax policy."

Were the state to take the sensible step of fully eliminating the state income tax deduction, the Department of Taxation estimates that Hawai'i would collect approximately **\$63 million** in new revenue.³⁴

3

Reinstate the 2009 Tax Increase on Wealthy Households - In 2009, the state increased income tax rates on individuals making over \$96,000 per year. In 2015, those tax rates were allowed to sunset, resulting in Hawai'i's wealthiest residents receiving a **\$48.6 million** tax reduction, with 93% of that money going to the top 1% of income earners.³⁵

NEW REVENUE SOURCES

4

Eliminate the Tax Break for Capital Gains Income - Hawai'i is one of just eight states that provides a substantial tax break for capital gains income. The tax break given to capital gains is one of the most inequitable features of the Hawai'i state tax system, with 92 percent of the benefit going to the richest one percent of Hawai'i residents. Moreover, it is extended to non-residents who profit from trading investment assets, such as local real estate.

If the state would tax capital gains at the same rates as income from other sources, it would generate around **\$14.8 million** in additional revenue.³⁶

5

Prevent High-Income Taxpayers from Benefitting from Lower Tax Brackets - While Hawai'i's maximum marginal tax rate of 11 percent kicks in at \$200,000 for a single taxpayer and \$400,000 for married couples filing jointly, households above these income levels do not pay an 11 percent tax on all of their income. Even multimillionaires benefit by having the first \$400,000 they earn in any given year taxed at the state's lower marginal tax rates of 1.4 percent to 10 percent.

While this marginal tax rate structure may make sense for most taxpayers, three states— Connecticut, Nebraska, and New York—have made it more equitable by enacting measures that gradually phase out these lower rates for the very richest taxpayers. Adopting a similar approach in Hawai'i would raise millions of dollars in additional tax revenues and reduce the intense regressivity of the state's overall tax system.

6

Create a Single Net Corporate Income Tax Rate - Hawai'i currently taxes corporate income at different rates based upon income, in tax brackets ranging from 4.4 to 6.4 percent.³⁷ This tiered corporate tax structure is somewhat unique: 31 other states have a single rate. Our top corporate income tax rate is the 19th lowest in the nation, and our per-capita corporate tax collections are the 9th lowest. Consolidating our corporate income tax brackets and raising the net corporate income tax rate to 9 percent is projected to generate approximately **\$27.2 million** in new revenues.

7

Eliminate the "Dividends Paid" Deduction for a Real Estate Investment Trusts - Real estate investment trusts (REITs) are business entities developed in the mid-1960s to enable small investors to invest in income-producing real estate.³⁸ A REIT is taxed as a corpora-

NEW REVENUE SOURCES

tion but allowed to deduct all of its dividend payments from its taxable income. This tax structure causes much of the income produced by local real estate to go untaxed in Hawai'i.

Because REITs are so common in Hawai'i, and because the majority of REIT shareholders do not live in Hawai'i, estimating the exact amount of revenue that the state is losing is difficult. However, analyses of the larger REITs that own property in Hawai'i suggest potential tax revenues from **\$30 to \$50 million**.

CONCLUSION

The EITC is one of the best investments our state can make to help our workers and economy now and in the future. It addresses our unfair tax system, while keeping costs modest, and puts dollars back into the pockets of working families. Hawai'i has the highest cost of living in the nation, but we can use a state refundable EITC to provide relief that many of our state's residents need. It is a targeted and affordable way to relieve the tax burden for our low and moderate-income families, help people to move into the middle class, and boost the local economy.

ENDNOTES

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APPENDIX A: NATIONAL SUPPORTERS OF THE EITC

Alliance for a Just Society	Children’s Leadership Council	Hispanic National Bar Association
Alliance for Strong Families and Communities	Christian Community Development Association	Interfaith Worker Justice
American Academy of Pediatrics	Citizens for Tax Justice	Jewish Council for Public Affairs
American Federation of State, County and Municipal Employees (AFSCME)	Coalition on Human Needs	Jobs With Justice
American Psychological Association	Common Sense Kids Action	Labor Council for Latin American Advancement, AFL-CIO (LCLAA)
Americans for Democratic Action (ADA)	Community Action Partnership	League of Women Voters of the United States
Americans for Tax Fairness	Community Organizations in Action	Loretto Community
Association for Ambulatory Behavioral Healthcare	Corporation for Enterprise Development (CFED)	Lutheran Services in America
Association of University Centers on Disabilities	CSH (Corporation for Supportive Housing)	Mainstreet Alliance
Center for American Progress Action Fund	Disability Rights Education & Defense Fund	MALDEF
Center for Community Change	Disciples Justice Action Network	MomsRising
Center for Global Policy Solutions	Early Care and Education Consortium	NAACP
Center for Law and Social Policy	Ecumenical Poverty Initiative	National Alliance of Children’s Trust & Prevention Funds
Center for Public Justice	Enterprise Community Partners	National Alliance of Community Economic Development Associations (NACEDA)
Center for Rural Strategies	Esperanza	National Alliance of HUD Tenants
Center for the Study of Social Policy	Every Child Matters Education Fund	National Alliance to End Homelessness
Center on Budget and Policy Priorities	Feeding America	National Association for Children’s Behavioral Health
Child Care Aware of America	First Focus Campaign for Children	National Association for Latino Community Asset Builders (NALCAB)
Child Welfare League of America	Food Research & Action Center (FRAC)	National Association for the Education of Young Children (NAEYC)
Children’s Defense Fund	Futures Without Violence	National Association of Community
	Goodwill Industries International	

APPENDIX A: NATIONAL SUPPORTERS OF THE EITC

Health Centers	National Health Care for the Homeless Council	Public Advocacy for Kids
National Association of County Human Services Administrators	National Hispanic Media Coalition	RESULTS
National Association of Social Workers (NASW)	National Hispanic Medical Association	SEIU
National Black Child Development Institute	National Human Services Assembly	Share Our Strength
National Center on Adoption and Permanency	National Immigration Law Center	SourceAmerica
National Center on Domestic and Sexual Violence	National Latino Evangelical Coalition	The Arc of the United States
National Child Support Enforcement Association (NCSEA)	National LGBTQ Task Force Action Fund	The Jewish Federations of North America
National Coalition Against Domestic Violence	National Low Income Housing Coalition	The Leadership Conference on Civil and Human Rights
National Coalition for Asian Pacific American Community Development	National Network to End Domestic Violence	The National Crittenton Foundation
National Committee to Preserve Social Security and Medicare	National Organization for Women	The Salvation Army National Headquarters
National Council of Jewish Women	National Recreation and Park Association	The United Methodist Church – General Board of Church and Society
National Council of La Raza (NCLR)	National Resource Center on Domestic Violence	Treatment Communities of America
National Council on Independent Living (NCIL)	National Urban League	Union for Reform Judaism
National Disability Rights Network	National WIC Association	United Auto Workers
National Domestic Violence Hotline	National Women’s Law Center	United for a Fair Economy
National Education Association	Our Developing World	United Way Worldwide
National Employment Law Project (NELP)	OWL-The Voice of Women 40+	USAction
National Head Start Association (NHSA)	Partnership for America’s Children	Voices for Progress
	PICO National Network	Women’s Institute for a Secure Retirement (WISER)
	Presbyterian Church (U.S.A.)	

APPENDIX B: ADAPTING HAWAII'S TAX FORMS TO INCLUDE A STATE EITC

Changing the state tax code often means expensive and cumbersome changes to individual tax forms. New schedules, complex instructions, and lengthy tables can become barriers for eligible filers. However, integrating a state Earned Income Tax Credit (EITC) into Hawaii's tax form couldn't be simpler.

Eligibility and credit amounts for state EITCs are typically based on a filer's federal EITC amount. Under these types of state-level credits, filers receive a state tax credit equal to a set percentage of the filer's federal EITC amount. This is part of the reason that 24 states and the District of Columbia have created refundable state EITCs, and 3 have created non-refundable state EITCs.

Michigan: A Straightforward Example

Michigan's state EITC illustrates the simplicity of adapting existing tax forms and instructions to accommodate a state EITC. Michigan offers a 6% state EITC. That is, a filer who received a \$1,000 federal EITC is entitled to a \$60 refundable state credit.

Because Michigan bases their credit on the federal EITC amount, adapting their tax form is as simple as adding two lines to the "Refundable Credits and Payments" section of the form.

23. USE TAX, Use tax due on Internet, mail order or other out-of-state purchases from Worksheet 1 (see instructions)	23	00
24. Total Tax Liability, Add lines 21, 22 and 23	24	00
REFUNDABLE CREDITS AND PAYMENTS		
25. Property Tax Credit, Attach MI-1040CR or MI-1040CR-2	25	00
26. Farmland Preservation Credit, Attach MI-1040CR-5	26	00
27. a. Federal Earned Income Tax Credit	27a	00
b. Michigan Earned Income Tax Credit, Multiply line 27a by 6% (0.06)	27b	00
28. Michigan Historic Preservation Tax Credit (refundable), Attach Form 3581	28	00

Additionally, because calculating the state-level credit is so easy, the instructions for claiming are equally brief.

Line 27: Michigan Earned Income Tax Credit (EITC). Taxpayers who are eligible to claim an EITC on their federal return may claim a Michigan EITC equal to 6 percent of the taxpayer's federal credit. To claim the Michigan credit, enter your federal EITC amount on line 27a and six percent of line 27a on line 27b.

Line 28: Michigan Historic Preservation Tax Credit. Enter the amount from your 2014 Historic Preservation

Our proposal for a Hawai'i state EITC follows this easy calculation method. Adjusting our tax forms to provide this much-needed boost to working families' income is simple and straightforward.



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The Hawai'i Appleseed Center for Law and Economic Justice is committed to a more socially just Hawaii, where everyone has genuine opportunities to achieve economic security and fulfill their potential. We change systems that perpetuate inequality and injustice through policy development, legislative advocacy, coalition building, and litigation.

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