



HAWAII APPLESEED

CENTER FOR LAW & ECONOMIC JUSTICE

Comments of Hawai'i Appleseed Center for Law and Economic Justice

Pertaining to the Final Report from the PFM Group on Studies of Hawaii's Tax System
State of Hawaii Tax Review Commission

Scheduled for discussion Tuesday, October 24, 2017 at 1:00 pm in Conference Rooms 310-313
of the Department of Labor and Industrial Relations

Dear Chair Takamura, Vice Chair Cook, and members of the Tax Review Commission:

Thank you for the opportunity to provide comments on the Final Report to the Tax Review Commission from the PFM Group on Studies of Hawaii's Tax System ("the final report"), dated September 30, 2017. Our comments on various sections of the final report are detailed below:

1. Current Structure Tax Burden

- **“Results show that Hawaii’s tax system is only progressive between low income and middle-income households. A family making \$25,000 pays approximately 6.0 percent of its income in Hawaii taxes. Families making \$50,000 up to \$150,000 pay approximately the same rate of 8.0 percent, with only mild escalation as incomes rise, (p. 45)”** is based loosely on the model used in the District of Columbia’s annual tax burden report.¹ In contrast, the District of Columbia report determined that Honolulu families making \$25,000 had a 17.7% tax burden, not a 6% tax burden. The final report states that it calculates a different tax rate for \$25,000 households “due to concerns over its property tax share of rent assumptions. (p. 54)” However, the non-partisan Institute on Taxation and Economic Policy (ITEP) comes to a conclusion that is close to that of the District of Columbia report, finding that Hawai'i families making less than \$18,000 a year pay 13.4%, and families making less than \$33,000 a year pay 12.2%, of their income in state and local taxes.²
- The final report also claims that, **“the recently enacted State Earned Income Tax Credit (EITC) effectively eliminates income taxes for the \$25,000 income household, which will significantly reduce the burden for these households and reduce taxes portion of these households’ income by 1.8 percent. Without the state EITC, state taxes would account for 7.7 percent of income for the \$25,000 income household, a rate on par with that of higher income households.”** However, the IRS EITC Assistant

¹<https://cfo.dc.gov/sites/default/files/dc/sites/ocfo/publication/attachments/2015%2051City%20Tax%20Burden%20Study%20Final.pdf>

²<https://itep.org/wp-content/uploads/whopaysreport.pdf>

shows that a family of three earning \$25,000 would receive \$633.40 in Hawai‘i state EITC,³ and according to the Department of Taxation, such a family would owe \$1,122 in income taxes, which close to double their EITC.⁴ Furthermore, a \$25,000 household with no children cannot claim the EITC at all. In these cases, the EITC certainly does not “effectively [eliminate] income taxes.”

2. Components and Comparison to Other States Tax Burden

- The final report states, “**Honolulu ties for eleventh most progressive in the nation, meaning Hawaii’s tax structure is very progressive when compared to most other states** (p. 54)” and concludes that Honolulu’s average increase in the effective tax rates between income gains of \$25,000 for families making between of \$25,000 and \$100,000 is 0.5%. As discussed above, the District of Columbia report, on which the final report bases its model, comes to the opposite conclusion, finding that the \$25,000 families pay a much higher tax rate than \$100,000 families. In addition, according to ITEP’s tax inequality index, Hawai‘i has a regressive tax structure that is the 15th most unfair state and local tax system in the U.S. ITEP also reports that Hawai‘i has the 2nd worst tax burden on people in poverty in the nation.⁵
- The final report also states, “**Nationally, Hawaii’s (Honolulu’s) middle class individual taxpayers have relatively low tax burdens** (p. 53).” Conversely, ITEP reports that the middle 20% of families in Hawai‘i have the 3rd highest tax burden on middle 20% families across the U.S.⁶

3. Current Measures of Regressivity

- While the final report accurately explains the distinction between a sales tax and Hawai‘i’s general excise tax (GET), it does not appear to fully factor into its calculations how much higher the effective GET rate is than the nominal 4% rate. The final report reads, “for comparison purposes, Hawai‘i’s GET is classified as a general excise or sales tax (p. 37),” notes that the general excise/sales tax rate is 4.0%, and says that Hawai‘i has the 40th highest tax rate amongst states. A footnote reads, “**A strong case can be made that Hawaii’s 4.0 GET rate is effectively higher when compared to state sales tax rates, because Hawaii applies the tax on multiple activities that get built into the price of finished goods and services (and then also subject to the GET). It is likely that the GET effective rate is in the range of 5 percent** (p.37).” In contrast, Lowell Kalapa, former president of the Tax Foundation of Hawai‘i, estimated that the 4% GET is equivalent to a 10% or 11% sales tax.⁷ Similarly, ITEP reports the GET consuming 11%

³ <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/use-the-eitc-assistant>,
<https://taxfoundation.org/hawaii-income-taxes-earned-income-credit/>

⁴ http://tax.hawaii.gov/forms/d_16table_p04/

⁵ <https://itep.org/wp-content/uploads/whopaysreport.pdf>

⁶ <https://itep.org/wp-content/uploads/whopaysreport.pdf>

⁷ <https://taxfoundation.org/state-and-local-sales-tax-rates-in-2017/>

of income for families making less than \$18,000 a year and 8.5% for families making less than \$33,000 a year, while those in the top 1% of income earners pay only 1.2% of their income to the GET.⁸

4. Revenue Strategies / Approaches

- **Alternative 3: Restoring the Surcharge on Rental Cars** (p. 80). During 2011-2012, Hawai‘i increased its surcharge on rental cars from \$3.00 to \$7.50 per day, but that increase was allowed to sunset on July 1, 2012. This alternative has the advantage that it would be borne almost entirely by out-of-state residents and likely would have only minimal impacts on the tourist industry, as demonstrated by the levels of travel activity during the period of the increased surcharge.⁹ Hawai‘i Appleseed endorses this alternative.
- **Alternative 8: Increasing the GET Rate to 4.5%** (p. 89). As noted above, because the GET taxes virtually goods and services in Hawai‘i, and many items are taxed multiple times by it, the actual current effective rate is estimated by reputable sources to be as high as 11%. A sales tax of this magnitude would place Hawai‘i ahead of the highest sales tax state, Louisiana, which has a 9.98% rate.¹⁰
- **Alternative 12: Moving to a Single 9% Corporate Net Income Tax Rate** (p. 95). While Hawai‘i taxes corporate income at different rates based on income level, most other states have a single rate. While a progressive tax structure makes sense in the context of individual income taxes, the “ability to pay” concept does not apply similarly to corporations. In addition, our per-capita corporate tax collections are low in comparison to other states.¹¹ Hawai‘i Appleseed endorses this alternative.
- **Alternative 18: Eliminating the Deduction for Property Taxes Paid** (p.104). Under virtually any measure, Hawai‘i has the lowest effective property tax rates in the nation. Hawai‘i also follows the federal treatment of income by allowing a deduction for federal taxes paid. The justification for this is that property taxes are generally the primary source of funding for public education, which uniquely does not apply in Hawai‘i, where public education funding is drawn entirely from state general revenues. In other words, property owners in Hawai‘i not only are not taxed to fund education, as they are in other states, but they also qualify to receive the additional benefit of the federal deduction. However, only those property owners with high enough incomes to itemize their deductions benefit from this property tax deduction.¹² Hawai‘i Appleseed endorses this alternative.

⁸ <https://itep.org/wp-content/uploads/whopaysreport.pdf>

⁹ <http://www.hiappleseed.org/sites/default/files/Hi%20Appleseed%20-%20Tax%20Report%20%282013%29.pdf>

¹⁰ <https://www.bizjournals.com/pacific/blog/2013/08/tax-foundations-ranking-for-hawaii.html>

¹¹ <http://hiappleseed.org/sites/default/files/EITC%20Report%20%5BFINAL%5D.pdf>

¹² <http://hiappleseed.org/sites/default/files/EITC%20Report%20%5BFINAL%5D.pdf>

5. Tax Structure Optimal Alternatives

- **Alternative 8: Adjusting the Food/Excise Tax IIT Credit** (p. 123). To lessen the burden on those families who are especially hard hit by the GET, our state leaders created the Food/Excise Tax Credit. The less a worker earns, the more he or she can get back. The Food/Excise Tax Credit was created in 2007, and the amounts that families could get back were updated to catch up with inflation in 2015. The income eligibility cut-offs for the credit have not been adjusted for inflation since 2007, which means that fewer and fewer of our low-income and working-class families can claim the credit. The credit should be adjusted to at least restore the income thresholds and amounts to where they were in 2007 and be automatically updated for inflation in the future. Considering the increase in costs of living over the past decade, an additional increase in the level of the credit is justifiable as well.¹³ Hawai‘i Appleseed endorses this alternative.
- **Make the EITC refundable** (p. 130). This alternative is currently in the “less desirable alternatives” section, but the merits of this proposal should be more strongly considered. While the passage of the Hawai‘i EITC in 2017 will provide some needed relief to low-income and working-class families, its non-refundability seriously reduces its impact. Only if tax credits are refundable can filers get tax refunds when their credits total more than the amount of income tax that they owe. Without refundability, the state EITC is not able to return significant portions of GET payments to lower-income families, since the amount that they pay in the GET is so much larger than the amount that they owe in state income taxes. That is why making the EITC refundable is essential to provide adequate tax relief to the state’s low-income and working-class families.¹⁴ Hawai‘i Appleseed endorses this alternative.

6. Hawai‘i Appleseed's Additional Recommendations

There are several tax proposals that Hawai‘i Appleseed supports that were not included in the final report:

- **Low-Income Household Renters Credit.** The Low-Income Household Renters’ Credit was created in 1977 to provide meaningful tax relief to low- and moderate-income households in Hawai‘i. However, it has not been updated in nearly three decades. In 1981, the credit was set to \$50 per exemption. The income eligibility cut off was set to \$30,000 in 1989, which was just above the median household income at the time. Neither of those levels have budged since then. The credit should be adjusted to recover ground lost to inflation by increasing both the maximum value of the credit and the income eligibility limits.¹⁵

¹³ <http://hitaxfairness.org/food-credit/>

¹⁴ <http://hitaxfairness.org/wp-content/uploads/2017/04/Why-we-need-tax-credits.pdf>

¹⁵ <http://hitaxfairness.org/renters-credit/>

- **Eliminate the State Income Tax Deduction.** Hawai‘i is one of a tiny minority of 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. 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.”¹⁶
- **Eliminate the Tax Break for Capital Gains Income.** Hawai‘i is one of a small minority of 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% of the benefit going to the richest 1% of Hawai‘i residents. Moreover, it is extended to non-residents who profit from trading investment assets, such as local real estate.¹⁷
- **Eliminate the Income Tax for People in Poverty.** Hawai‘i places the 2nd highest tax burden in the country on our low-income households. Our lowest-income households pay over 13% of their income in taxes, while those at the top pay 8% or less. In fact, we are in the minority of states that actually pushes low-income people deeper into poverty with taxes.¹⁸ To provide much-needed tax relief to the state’s low-income families, Hawai‘i should join most other states and eliminate income tax liability for those who are living in poverty.
- **Eliminate the “Dividends Paid” Deduction for 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. A REIT is taxed as a corporation, but it is allowed to deduct all of its dividend payments from its taxable income. REITs are common in Hawai‘i, but the majority of REIT shareholders do not live in the state. As a result, this tax structure causes much of the income produced by local real estate to go untaxed in Hawai‘i.¹⁹

The Hawai‘i Appleseed Center for Law and Economic Justice is committed to 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, advocacy, and coalition building.

¹⁶ <http://hiappleseed.org/sites/default/files/EITC%20Report%20%5BFINAL%5D.pdf>

¹⁷ <http://hiappleseed.org/sites/default/files/EITC%20Report%20%5BFINAL%5D.pdf>

¹⁸ http://www.nccp.org/publications/pdf/text_1093.pdf

¹⁹ <http://hiappleseed.org/sites/default/files/EITC%20Report%20%5BFINAL%5D.pdf>