TAX REVIEW COMMISSION 2025-2027

Eighth Meeting

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Pension Income and Taxation

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PENSION INCOME TAX EXEMPTION IN HAWAIʻI

- Under Hawaiʻi Revised Statutes § 235-7(a)(2)-(3) and administrative rule HAR § 18-235-7-03, retirement benefits received by reason of retirement, disability, or death are exempt from state income tax if they are:
  - Funded entirely by the employer, and
  - Qualified as pension, profit-sharing, etc.
- This means:
  - Government pensions (e.g., ERS for state/county employees), federal civil service, military retirement, and other qualified employer-funded pensions are fully exempt for residents
  - Private defined-benefit pensions may also qualify, provided the employer funded them and the employee made no contributions

PENSION INCOME TAX EXEMPTION IN HAWAIʻI

- **Employees' Retirement System (ERS):** established in 1926 and currently provides retirement, disability, survivor, and other benefits.
- As of June 30, 2025, ERS reported 162,601 total members, broken down as:
  - 66,826 active members
  - 56,673 retirees and beneficiaries
  - 39,102 inactive, non-retired members
- **Employee contributions to the ERS are subject to the State income tax upfront**
- However, otherwise, federally taxed pension amounts are exempt from Hawaiʻi income taxes

PENSION INCOME TAX EXEMPTION IN HAWAI‘I

- **Contributions made by the employee**—such as:
  - Traditional **IRA** or **401(k)** withdrawals,
  - Portions of pensions funded through **employee contributions**, are fully taxable in Hawai‘i

RECOMMENDATIONS FROM PAST TAX REVIEW COMMISSIONS

<u>2001-2003 Tax Review Commission (TRC):</u>

- Based on concerns for equity and fairness, all forms of retirement income should be taxed the same, regardless of its source from 401(k) plans, pension plans, profit sharing plans, IRA, SEP, 457, or 403(b) plans.
- Any changes in this area should be made with great care and only after additional analysis
- Repeal should have a delayed phase in and not apply to persons who retire before that date, in order not to penalize current and prospective retirees who have made their financial plans based on the exemption of their current and future retirement benefits.

RECOMMENDATIONS FROM PAST TAX REVIEW COMMISSIONS

<u>2005-2007 Tax Review Commission (TRC):</u>

- People have made employment decisions based on the current tax treatment. For example, some may have accepted smaller government pensions on the expectation that they would not be taxed.
- People have also made decisions on where to live based on the current tax law.
- Excluding a base amount (e.g. $50,000) would ameliorate the effect of this change on those now receiving tax-free pensions and would remove the effect entirely for those with small pensions (i.e. those below the base exclusion).

RECOMMENDATIONS FROM PAST TAX REVIEW COMMISSIONS

<u>2015-2017 Tax Review Commission (TRC):</u>

- Conform to the federal tax treatment of social security income and employer-provided pensions, after allowing a deduction for income attributable to employee contributions that were subject to state or municipal taxes. (i.e. the already taxed ERS contributions)

- To lessen the burden of the tax change on retirees, enact with a 5-year lag.

RECOMMENDATIONS FROM PAST TAX REVIEW COMMISSIONS

<u>2020-2022 Tax Review Commission (TRC):</u>

- Tax previously untaxed retirement income
- Allow deductions for contributions to previously untaxed pension plans (Current contributors into the ERS and similar systems have not been allowed deductions for their contributions. Due to the lack of deductions for contributions, taxing withdrawals would expose pensioners to double taxation of their retirement principal)
- Exempt the first $25,000 of contributory pension income received per recipient for 25 years after taxation of pensions begins

RESIDENT PENSION INCOME STATISTICS BY FILING STATUS - TAX YEAR 2019										
Filing Status	No. of Returns	% of Total	Pension Income					% with Pension Inc	Federal AGI ($ m)	Pension Inc/FAGI %
			Number	% of Total	$ million	% of Total	Avg ($)			
Married Filing Jointly	222,585	34.1%	60,565	53.2%	$2,696	64.3%	$44,515	27.2%	$28,635	9%
Single	342,771	52.6%	48,118	42.3%	$1,348	32.2%	$28,009	14.0%	$13,830	10%
Married Filing Separately	15,650	2.4%	1,649	1.4%	$52	1.2%	$31,735	10.5%	$1,072	5%
Head of Household	70,490	10.8%	3,404	3.0%	$90	2.1%	$26,304	4.8%	$3,453	3%
Qualifying Widow(er)	397	0.1%	132	0.1%	$4	0.1%	$33,398	33.2%	$24	19%
	651,893	**100%**	**113,868**	**100%**	**$4,190**	**100%**	**$36,798**	**17.5%**	**$47,014**	9%
				Highest value		Second highest value				

- Most resident taxpayers have single filing status, whereas a majority of resident taxpayers with pension income are married filing jointly.
- Average pension income per return is $36,798
- The total resident pension income is $4.2 billion (8.9% of Hawai‘i Net Total Income)
- Widow(er)s: The group with highest fraction relying on pensions among resident taxpayers and report the largest share of income attributable to pensions

RESIDENT PENSION INCOME STATISTICS BY HAWAII AGI CLASS - TAX YEAR 2019													
Hawaii AGI Class			No. of Returns	% of Total	Pension Income					% with Pension Inc	Hawaii AGI ($ m)	Pension Inc/HAGI %
					Number	% of Total	$ million	% of Total	Avg ($)			
Less	than	$0	13,178	2.0%	6,103	5.4%	$333	8.0%	$54,619	46.3%	-$848	n/a
$0	to under	$10,000	122,753	18.8%	37,805	33.2%	$1,210	28.9%	$32,000	30.8%	$442	274%
$10,000	to under	$20,000	74,378	11.4%	12,975	11.4%	$489	11.7%	$37,700	17.4%	$1,103	44%
$20,000	"	$30,000	71,240	10.9%	9,429	8.3%	$354	8.4%	$37,525	13.2%	$1,781	20%
$30,000	"	$40,000	66,984	10.3%	7,620	6.7%	$274	6.5%	$35,980	11.4%	$2,336	12%
$40,000	"	$50,000	54,725	8.4%	6,242	5.5%	$220	5.2%	$35,229	11.4%	$2,451	9%
$50,000	"	$75,000	89,576	13.7%	10,943	9.6%	$389	9.3%	$35,560	12.2%	$5,477	7%
$75,000	"	$100,000	52,900	8.1%	7,069	6.2%	$254	6.1%	$35,934	13.4%	$4,584	6%
$100,000	"	$150,000	57,153	8.8%	8,036	7.1%	$310	7.4%	$38,622	14.1%	$6,928	4%
$150,000	"	$200,000	23,748	3.6%	3,414	3.0%	$141	3.4%	$41,344	14.4%	$4,074	3%
$200,000	"	$300,000	14,679	2.3%	2,408	2.1%	$113	2.7%	$46,783	16.4%	$3,487	3%
$300,000	"	$400,000	4,539	0.7%	768	0.7%	$38	0.9%	$49,037	16.9%	$1,559	2%
$400,000	and	over	6,040	0.9%	1,056	0.9%	$65	1.5%	$61,465	17.5%	$8,328	1%
		TOTAL	**651,893**	**100%**	**113,868**	**100%**	**$4,190**	**100%**	**$36,798**	**17.5%**	**$41,701**	10%

Highest value   Second highest value

- Tax exempt pension income is reported in 17.5% of resident returns.
- Majority of pensioners are naturally in the lowest Hawai‘i AGI (HAGI) classes since HAGI excludes pension income and SSB

RESIDENT PENSION INCOME STATISTICS BY FEDERAL AGI CLASS - TAX YEAR 2019													
Federal AGI Class			No. of Returns	% of Total	Pension Income					% with Pension Inc	Federal AGI ($ m)	Pension Inc/FAGI %
					Number	% of Total	$ million	% of Total	Avg ($)			
Less	than	$0	7,884	1.2%	714	0.6%	$12	0.3%	$16,414	9.1%	-$851	n/a
$0	to under	$10,000	91,452	14.0%	6,847	6.0%	$38	0.9%	$5,620	7.5%	$379	10.1%
$10,000	to under	$20,000	69,819	10.7%	8,860	7.8%	$100	2.4%	$11,317	12.7%	$1,036	9.7%
$20,000	"	$30,000	68,944	10.6%	7,801	6.9%	$126	3.0%	$16,199	11.3%	$1,726	7.3%
$30,000	"	$40,000	66,147	10.1%	7,169	6.3%	$140	3.3%	$19,579	10.8%	$2,309	6.1%
$40,000	"	$50,000	55,672	8.5%	7,239	6.4%	$175	4.2%	$24,135	13.0%	$2,496	7.0%
$50,000	"	$75,000	98,291	15.1%	18,910	16.6%	$562	13.4%	$29,722	19.2%	$6,034	9.3%
$75,000	"	$100,000	63,310	9.7%	16,223	14.2%	$672	16.0%	$41,439	25.6%	$5,493	12.2%
$100,000	"	$150,000	71,042	10.9%	21,143	18.6%	$1,037	24.7%	$49,025	29.8%	$8,618	12.0%
$150,000	"	$200,000	29,416	4.5%	9,536	8.4%	$581	13.9%	$60,928	32.4%	$5,042	11.5%
$200,000	"	$300,000	17,744	2.7%	6,027	5.3%	$432	10.3%	$71,750	34.0%	$4,217	10.3%
$300,000	"	$400,000	5,501	0.8%	1,718	1.5%	$148	3.5%	$85,986	31.2%	$1,882	7.8%
$400,000	and	over	6,671	1.0%	1,681	1.5%	$166	4.0%	$98,822	25.2%	$8,631	1.9%
		TOTAL	**651,893**	**100%**	**113,868**	**100%**	**$4,190**	**100%**	**$36,798**	**17.5%**	**$47,014**	8.9%

Highest value   Second highest value

- Majority of pensioners are indeed in the middle Federal AGI (FAGI) classes since FAGI includes pension income and SSB

RESIDENT PENSIONER+SSB RECIPIENT NET TAX LIABILITY STATISTICS BY FEDERAL AGI CLASS - TAX YEAR 2019

Federal AGI Class			No. of Returns	% of Total	Net Tax Liab.	% of Total	New Net Tax Liability ($ mil)				New Net Tax Liability (% of Total)			
							Pen	Pen+SS	RedPen25	RedPen12.5	Pen	Pen+SS	RedPen25	RedPen12.5
Less	than	$0	725	0.5%	-$0.19	-0.04%	-$0.16	-$0.16	-$0.18	-$0.17	-0.02%	-0.02%	-0.03%	-0.03%
$0	to under	$10,000	7,259	4.9%	-$0.93	-0.21%	-$0.8	-$0.76	-$0.94	-$0.94	-0.11%	-0.09%	-0.18%	-0.16%
$10,000	to under	$20,000	10,524	7.2%	-$1	-0.14%	$1	$2	-$1	-$1	0.19%	0.18%	-0.12%	-0.11%
$20,000	"	$30,000	11,633	7.9%	$2	0.36%	$5	$7	$2	$2	0.76%	0.83%	0.31%	0.34%
$30,000	"	$40,000	10,728	7.3%	$4	0.85%	$9	$13	$4	$5	1.28%	1.50%	0.74%	0.83%
$40,000	"	$50,000	10,360	7.0%	$6	1.28%	$13	$19	$6	$8	1.85%	2.23%	1.17%	1.35%
$50,000	"	$75,000	25,930	17.6%	$24	5.43%	$53	$77	$28	$36	7.54%	9.14%	5.43%	6.11%
$75,000	"	$100,000	20,780	14.1%	$32	7.05%	$67	$93	$38	$48	9.55%	11.05%	7.34%	8.18%
$100,000	"	$150,000	25,709	17.5%	$69	15.43%	$136	$174	$85	$105	19.43%	20.71%	16.36%	17.94%
$150,000	"	$200,000	11,320	7.7%	$56	12.45%	$97	$115	$70	$81	13.91%	13.71%	13.41%	13.91%
$200,000	"	$300,000	7,326	5.0%	$67	14.87%	$99	$112	$81	$89	14.24%	13.35%	15.58%	15.24%
$300,000	"	$400,000	2,278	1.5%	$36	8.04%	$48	$53	$43	$45	6.87%	6.27%	8.20%	7.70%
$400,000	and	over	2,547	1.7%	$156	34.62%	$171	$178	$166	$168	24.50%	21.14%	31.80%	28.70%
		TOTAL	**147,119**	**100%**	**$449**	**100%**	**$699**	**$841**	**$521**	**$585**	**100%**	**100%**	**100%**	**100%**
				Increase in Total Liability			**$249**	**$392**	**$72**	**$136**				

- While net tax liabilities increase across the board, the tax liability share of lower income brackets increase since they are more likely to depend on retirement income only: **Signs of Regressivity**

RESIDENT PENSIONER+SSB RECIPIENT NET TAX LIABILITY STATISTICS BY FEDERAL AGI CLASS - TAX YEAR 2019

Federal AGI Class			No. of Returns	% of Total	Net Tax Liab.	% of Total	Change in Avg. Net Tax Liability				% Change in Net Tax Liability			
							Pen	Pen+SS	RedPen25	RedPen12.5	Pen	Pen+SS	RedPen25	RedPen12.5
Less	than	$0	725	0.5%	-$0.19	-0.04%	$36	$36	$16	$22	14.0%	14.0%	6.2%	8.5%
$0	to under	$10,000	7,259	4.9%	-$0.93	-0.21%	$22	$24	-$1.2	-$0.9	17.3%	18.8%	-0.9%	-0.7%
$10,000	to under	$20,000	10,524	7.2%	-$1	-0.14%	$183	$207	$0	$1	303.4%	341.4%	-0.3%	197.9%
$20,000	"	$30,000	11,633	7.9%	$2	0.36%	$317	$463	-$1	$31	225.8%	329.8%	-0.8%	21.9%
$30,000	"	$40,000	10,728	7.3%	$4	0.85%	$478	$818	$2	$99	134.5%	230.2%	0.6%	27.8%
$40,000	"	$50,000	10,360	7.0%	$6	1.28%	$696	$1,259	$35	$210	125.6%	227.3%	6.2%	37.9%
$50,000	"	$75,000	25,930	17.6%	$24	5.43%	$1,091	$2,024	$150	$439	115.9%	215.1%	16.0%	46.6%
$75,000	"	$100,000	20,780	14.1%	$32	7.05%	$1,685	$2,948	$315	$780	110.5%	193.3%	20.6%	51.1%
$100,000	"	$150,000	25,709	17.5%	$69	15.43%	$2,584	$4,079	$617	$1,387	95.8%	151.3%	22.9%	51.4%
$150,000	"	$200,000	11,320	7.7%	$56	12.45%	$3,645	$5,243	$1,228	$2,249	73.7%	106.1%	24.8%	45.5%
$200,000	"	$300,000	7,326	5.0%	$67	14.87%	$4,458	$6,203	$1,955	$3,051	48.9%	68.0%	21.4%	33.5%
$300,000	"	$400,000	2,278	1.5%	$36	8.04%	$5,225	$7,298	$2,902	$3,929	33.0%	46.0%	18.3%	24.8%
$400,000	and	over	2,547	1.7%	$156	34.62%	$6,129	$8,760	$3,959	$4,880	10.0%	14.3%	6.5%	8.0%
		TOTAL	**147,119**	**100%**	**$449**	**100%**	**$1,695**	**$2,664**	**$487**	**$925**	**55.5%**	**87.2%**	**15.9%**	**30.3%**

- **Percentage increases in net tax liability are higher for lower income groups when no base exemptions in new policy: Signs of Regressivity**
- Base exemptions shield lower-income retirees from increased tax burden

Mahalo nui loa

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