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A DUBIOUS HONOR FOR HAWAII

Legislative Action in Alabama Moves Hawaii's Income Tax to the Top in Taxing Poor Working Families

By Jason A. Levitis and Nicholas Johnson

Last week, Alabama's governor signed into law new legislation that provides major income tax relief to low-income working families. As a result of this change in Alabama law, Hawaii — which was second to Alabama in the burden its income tax imposes on the poor — is on track to inherit Alabama's standing as the highest taxer of the earnings of the poor. However, there is still time for Hawaii to take legislative action to avoid this dubious honor.

Hawaii's Income-Tax Treatment of Low-Income Working Families. Hawaii's income tax imposes a major burden on poor and near-poor working families. A study of state income tax systems in 2005¹ ranked Hawaii among the top four in every measure of income tax burden on low-income families, and second only to Alabama by many measures. (See Table 1.) Hawaii was second to Alabama in the amount of income tax it charges one-parent families of three and two-parent families of four at the federal poverty line, as well as one-parent families of three earning 25 percent

Table 1. Effect of Alabama Legislation on Hawaii's Rankings In Measures of Income Tax Burden on Low-Income

Measure of Tax Burden	Income	Tax Due in Hawaii	Hawaii's Rank Without New Alabama Law (out of 42)	Hawaii's Rank Based on New Alabama Law* (out of 42)
Income Tax on:				
One-Parent Families of Three at Poverty Line	\$15,577	\$373	2	1
Two-Parent Families of Four at Poverty Line	19,961	470	2	1
One-Parent Families of Three at 125% Poverty	19,471	612	2	1
Two-Parent Families of Four at 125% Poverty	24,951	808	3	3
Income at which Income Tax begins to be Levied on:				
One-Parent Families of Three	9,800	—	3	2
Two-Parent Families of Four	11,500	—	4	3
Source: Center on Budget and Policy Priorities				
* Reflects tax year 2005 rankings if Alabama's new law had been in effect.				

¹ Jason A. Levitis and Nicholas Johnson, "The Impact of State Income Taxes on Low-Income Families in 2005," Center on Budget and Policy Priorities, February, 2006.

more than the poverty line. Hawaii's income tax thresholds — the lowest income level at which families must pay income tax — also were among the lowest in the nation and well below the poverty line. Overall, Hawaii's income tax in 2005 was second only to Alabama's in the burden it imposed on low-income families, and it was far outside the national mainstream.

The Alabama Legislation. Alabama's House Bill 292, passed unanimously by Alabama's legislature and signed into law by Governor Riley on April 12, provides major income tax relief to poor working families. The bill raises the standard deduction and the child tax credit for low-income families beginning in 2007. As a result, Alabama will improve in every measure of tax burden on low-income families. (See Table 2 for examples.)

Hawaii's New Rankings. As a result of the Alabama legislation, Hawaii's income tax is on course to become the harshest in the nation on low-income families in 2007. Hawaii will levy the highest tax in the nation on families of three and four at the poverty line, and on families of three earning 25 percent more than the poverty line. And it will climb into the top three in every measure

Single-Parent Families of Three				Two-Parent Families of Four			
Rank	State	Income	Tax	Rank	State	Income	Tax
4	Alabama (old law)	\$15,577	\$458	4	Alabama (old law)	\$19,961	\$538
1	Hawaii	15,577	373	1	Hawaii	19,961	470
2	West Virginia	15,577	287	2	Arkansas	19,961	406
3	Alabama (new)	15,577	253	3	Virginia	19,961	389
4	Michigan	15,577	186	4	West Virginia	19,961	378
5	Louisiana	15,577	155	5	Oregon	19,961	310
6	Montana	15,577	143	6	Alabama (new law)	19,961	293
7	Arkansas	15,577	126	7	Michigan	19,961	232
8	Oregon	15,577	117	8	Indiana	19,961	222
9	Ohio	15,577	90	9	Montana	19,961	209
10	Georgia	15,577	82	10	Iowa	19,961	183

* Reflects tax year 2005 rankings if Alabama House Bill 292 had been in effect.

of income tax burden on the working poor. Overall, Hawaii's income tax system will be the nation's most burdensome on families working to escape poverty.

The Importance of Low-Income Tax Relief in Hawaii. The high income taxes Hawaii imposes on working poor families create a barrier to families working their way into the middle class. Hawaii's income tax code is of particular concern because of the state's high cost of living. Escaping poverty requires more take-home pay in Hawaii than in the rest of the country, and Hawaii's income tax system compounds that challenge.

Prospects for Legislative Action. Time is short to prevent Hawaii from assuming the title of nation's highest taxer of the earnings of the working poor. While Governor Lingle and legislators from both parties have proposed promising legislation, nothing has been enacted. One straightforward solution, which draws on proposals advanced by legislators and the governor, is a combination of an increase in the standard deduction and a state Earned Income Tax Credit. Hawaii's standard deduction is among the lowest in the nation, and it lacks a state EITC altogether. Both provisions are easily implemented. Together, these provisions would move Hawaii's income tax system from the extreme into the national mainstream.