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HAWAII'S INCOME TAX ON THE WORKING POOR: A POST-SESSION UPDATE

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On June 26, Hawaii Governor Linda Lingle signed SB 1882, which expands Hawaii's refundable low-income tax credit. The bill's passage follows a long debate about how best to cut taxes on Hawaii's low-income working families, who face higher income taxes than such families in almost any other state.[1]

SB 1882 provides important help for low-income working families with children. But even with tax cuts enacted in 2006, SB 1882 is not sufficient to eliminate income taxes on working poor families.[2] Despite the improvements SB 1882 provides, Hawaii will continue to levy high taxes on poor families — higher than almost every other state.

Table 1. Income Tax Levied on Families at the Poverty Line, Before and After SB 1882 (Worst Ten States Out of 42 with Income Taxes).

Single-Parent Families of Three				Two-Parent Families of Four			
Rank	State	Income	Tax	Rank	State	Income	Tax
~~1~~	~~Hawaii (before)~~	~~$16,079~~	~~$291~~	1	Alabama	$20,615	$383
1	Alabama	$16,079	278	~~2~~	~~Hawaii (before)~~	~~20,615~~	~~379~~
2	**Hawaii (after)**	**16,079**	**156**	2	Oregon	20,615	282
3	Montana	16,079	142	3	Indiana	20,615	239
4	Arkansas	16,079	135	4	Iowa	20,615	218
5	Georgia	16,079	97	5	Montana	20,615	211
6	Ohio	16,079	93	**6**	**Hawaii (after)**	**20,615**	**199**
7	Illinois	16,079	89	7	Illinois	20,615	192
8	Indiana	16,079	86	8	Georgia	20,615	160
9	Oregon	16,079	77	9	Ohio	20,615	159
10	Missouri	16,079	51	10	West Virginia	20,615	122

Source: Center on Budget and Policy Priorities

Note: Calculations reflect tax law if all enacted changes were implemented in 2006, both in Hawaii and elsewhere, even if they take effect in future years. Both "Before" and "After" calculations include the effects of HB 957 (2006).

[1] See Jason A. Levitis, "The Impact of State Income Taxes on Low-Income Families in 2006," Center on Budget and Policy Priorities, March 2007.

[2] For an analysis of the 2006 tax cut legislation, HB 957, see Jason A. Levitis and Nicholas Johnson, "The Impact of Hawaii's Income Tax on Low-Income Families: An Update," Center on Budget and Policy Priorities, May 2006.

What SB 1882 does. SB 1882 increases the maximum value of the state's low-income credit from $35 per exemption to $85 per exemption, effective in tax year 2008.[3] The highest income at which families qualify for the credit is raised from $20,000 to $50,000. (The bill also re-labels the credit a "food/excise tax credit.") The dollar amounts are not indexed for inflation, so they will decline in purchasing power over time.

Hawaii will continue to tax low-income families more than almost every other state. Hawaii's income tax is among the very highest in the nation on the working poor. SB 1882 addresses the issue only partially. If SB 1882 were in effect today, Hawaii would remain among the states with the highest taxes on the working poor. For example:

- a single-parent family of three with poverty-level wages ($16,079 in 2006) would owe $156 in state income taxes, the second-highest amount in any state;
- the *tax threshold* — the lowest income at which a family owes tax — for a family of three would be $13,800, the sixth-lowest in the nation and over $2,000 below the poverty line;
- a family of four earning $25,770 (25 percent above the poverty line) would owe $482, the seventh-highest amount in the nation.[4]

Table 1 shows the states that levy the highest taxes on families with children at the federal poverty line, and how SB 1882 will affect Hawaii's ranking among these states. With SB 1882 in effect, Hawaii will continue to rank worse than all but a few states.

Table 2 shows the impact of Hawaii's income tax system on low-income families with children, before and after SB 1882 takes effect, as well as Hawaii's rankings compared to the 41 other states with income taxes. SB 1882 will leave Hawaii among the worst ten states in every measure of income tax burden on poor working families with children.

Table 2. The Impact of Hawaii's Income Tax on Low-Income Families, Before and After SB 1882 (and Rank Out of 42 States with Income Taxes).

	Before SB 1882		After SB 1882	
Measure of Tax Impact	Value	Rank (1 is worst)	Value	Rank (1 is worst)
Income Tax at the Federal Poverty Line for:				
One-Parent Families of Three (income: $16,079)	$291	1	$156	2
Two-Parent Families of Four (income: $20,615)	379	2	199	6
Income Tax at 125% of the Federal Poverty Line for:				
One-Parent Families of Three (income: $20,099)	544	1	409	6
Two-Parent Families of Four (income: $25,769)	662	4	482	7
Income Tax Threshold for:				
One-Parent Families of Three	10,400	3	13,800	6
Two-Parent Families of Four	14,000	3	17,800	8

Source: Center on Budget and Policy Priorities

Note: Calculations reflect tax law if all enacted changes were implemented in 2006, both in Hawaii and elsewhere, even if they take effect in future years. Both "Before" and "After" calculations include the effects of HB 957 (2006).

[3] Most families claim one exemption per family member.

[4] Calculations reflect tax law if enacted changes (in Hawaii and elsewhere) were implemented in 2006.

Why it matters. Taxing poor working families runs counter to decades of efforts from across the political spectrum to make work pay and help families lift themselves out of poverty. It is especially troubling in Hawaii, where the high cost of living makes escaping poverty even harder. Instead of helping poor working families get by, Hawaii is taxing them deeper into poverty.

What can be done. One effective option for reducing taxes is a state Earned Income Tax Credit, a refundable, inflation-adjusted credit targeted at low-income working families with children. Over half of the states with income taxes have enacted EITCs, including New Mexico and Louisiana in 2007. Extensive research has found that EITCs increase workforce participation and lift children out of poverty. A Hawaii state EITC equal to 10 percent of the federal EITC would exempt poor families with children from the income tax at moderate cost.[5]

[5] For more information on a state EITC in Hawaii, see Jason A. Levitis, "A State EITC Is a Cost-Effective Way to Ease Hawaii's High Income Tax Burden on the Poor," Center on Budget and Policy Priorities, February 2007.