Hawai`i Appleseed Center for LAW AND ECONOMIC JUSTICE

Generating Revenue to Support a Fairer Tax System

Hawaiʻi's working families are in dire need of relief from both the state's high cost of living and heavily regressive tax system. Targeted tax relief for low and moderate-income households can help families struggling to make ends meet. While a more progressive tax system will reduce the state's overall tax revenues, Appleseed recommends ten revenue-raising measures that would generate up to $689.6 million for the state—covering the $77 million cost of Appleseed's proposed low and moderate-income tax relief measures many times over and creating a more equitable tax system.

1. Eliminate the State Income Tax Deduction

Hawaiʻi 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 from their final state income tax bill for that same year. Wisely, Hawaiʻi partially repealed the deduction for high-earners, but the state should fully eliminate the state income tax deduction, resulting in approximately $70 million in new revenue.

2. Reinstate the Surcharge on Rental Cars

During 2011–2012, Hawaiʻi increased its surcharge on rental cars from $3.00 to $7.50 per day. Restoring the surcharge to the 2012 rate would result additional revenues of more than $65 million. This increase would be borne almost entirely by out-of-state residents, and based on travel activity, it does not appear that the temporary surcharge significantly impacted the industry.

3. Eliminate Tax Breaks for Capital Gains Income

Our state tax system is one of just eight that gives a substantial tax break to profits from the sale of investment assets. This preferential income tax rate solely benefits the wealthy, with 92 percent of the benefit going to the richest one percent of state taxpayers. Out of fairness, the state should tax capital gains at the same rates as income from other sources, bringing in around $31 million.

4. Require Online Retailers to Collect GET

Out of fairness, online retailers should collect sales taxes that would have been owed had they been located in the state. Online commerce diverts customers from local businesses, resulting in decreased local economic activity and reduced state tax revenues. Hawaiʻi should adopt legislation in conformity with the Streamlined Sales and Use Tax Agreement so that the state can begin annually collecting as much as $183.3 million in unpaid taxes on remotely-sold goods, a figure that will continue to rise significantly as online commerce expands.

5. Eliminate the Dividends Paid Deduction for Real Estate Investment Trusts

Real estate investment trusts (REITs) are business entities that enable small investors to invest in income-producing real estate. Although they are taxed like corporations, all dividends paid out to shareholders can be deducted from the REIT's income and REITs are *required* to pay out at least 90 percent of their income in dividends. Individual shareholders—most of whom are nonresidents—pay income tax on dividends received, but none of the REIT's income will be subject to Hawaiʻi income tax as long as it is paid out in dividends. Hawaiʻi should tax REIT income produced from local real estate; rough estimates suggest potential tax revenues from $30–$50 million.

6. Prevent High Income Earners From Benefitting From Lower Tax Brackets

Hawaiʻi has enacted some sensible limits on tax breaks that disproportionately benefit the state's most affluent residents, but the state still allows its wealthiest households to benefit from the lower marginal tax rates designed to benefit middle and lower-income residents. Gradually phasing out these lower tax rates would raise millions of dollars in additional tax revenues.

7. Create a Single Net Corporate Income Tax Rate

Hawaiʻi currently taxes corporate income at different rates based upon income in tax brackets ranging from 4.4–6.4 percent. The 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 $34.8 million in new revenues.

8. Eliminate Tax Breaks for Wealthy Retirees

Hawaiʻi is one of only ten states to provide a blanket exemption for government pensions, regardless of their income or wealth. It also offers one of the most generous private pension exemptions. Hawaiʻi's lawmakers should gradually phase out the pension exclusion for wealthy retirees, balancing the need for adequate long-term revenues with the desire to limit taxes on less affluent members of the state's older population. Estimates for revenue gains under the governor's 2011 proposed thresholds were approximately $206.7 million for fiscal year 2014.

9. Eliminate the Property Tax Deduction

Hawaiʻi has one of the lowest property tax rates in the nation and follows the federal tax code's treatment of income by allowing a deduction for property taxes paid, while renters and property owners who do not itemize deductions receive no benefit. Removing the property tax deduction would generate $12.5 million in new revenue.

10. Maintain the 2009 Tax Increases on Wealthy Households

To address budget shortfalls, in 2009 the state increased income tax rates on individuals making over $96,000 per year, limited itemized deductions, and phased out of the personal exemption for higher-income taxpayers. These progressive tax policies are set to expire in 2015. Hawaiʻi should make these progressive policies permanent.

For more information on these economic proposals, see Hawaiʻi Appleseed's 2013 report, "Creating a Fairer State Tax System and Economy for All Families," available at hiappleseed.org/tax-advocacy.

Total Estimates of Potential Revenue

Program	Potential Revenue
Eliminating State Income Tax Deduction	$70 million
Reinstating Rental Car Surcharge	$65 million
Eliminating Capital Gains Tax Break	$29 million
Collecting Online Sales Taxes	$183.3 million
Eliminating REIT's dividends paid deduction	$40 million
Creating Single Corporate Tax Rate	$34.8 million
Eliminating Tax Breaks for Wealthy Retirees	$206.7 million
Eliminating Property Tax Deduction	$12.5 million
Retaining High-Earner Tax Increases	$48.6 million
Total:	**$689.9 million**