



HAWAI'I'S EARNED INCOME TAX CREDIT:  
**NEXT STEPS**

T W E N T Y T W E N T Y

Nearly half of Hawai'i's residents struggle to make ends meet. Caught between rising costs and stagnant wages, families continue to fall behind despite working one or more jobs.

What if a public program could give these families more economic security, improve health and educational attainment, and support upward mobility?

There is such a program:

**It's called the Earned  
Income Tax Credit.**

## Summary

The Earned Income Tax Credit (EITC) is a powerful tool to help lift families out of poverty. It encourages work and the economic security needed to support healthy lives, get a good education, and increase future earnings. With decades of success at the federal level, most states and even some local governments have created complementary EITC programs.

The federal government and 24 of 29 states and the District of Columbia offer a *refundable* EITC. “Refundable” means that eligible tax filers get a refund if the tax credit they’ve earned is more than the taxes they owe.

Refundability makes the EITC much more effective, especially for families with the lowest incomes. That’s because these families are likely to qualify for tax credits that amount to more than their income tax liability. Unfortunately, the state EITC that Hawai‘i adopted in 2017 is not refundable. That means that the lowest-income households—the people who need it most—are not getting the full value of Hawai‘i’s tax credit.

**Creating our state EITC was an important achievement. Now it’s time to**

- **Make the state EITC refundable, and**
- **Remove the “sunset” provision that would end it in 2023.**

# The Earned Income Tax Credit

Experts consider the EITC to be the country's single most effective anti-poverty program.<sup>1</sup> In 2018, it boosted the economic security of more than 22 million low-income people, including 9 million children.<sup>2</sup>

The federal EITC program has been well-studied since it went into effect in 1975, and the research<sup>3,4</sup> consistently shows its positive results, including:

- Mothers and children in EITC households experience lower stress and better mental and physical health. Children may be especially vulnerable to stress so this has long-term implications.
- Pregnant women who benefit from EITC are more likely to get early and regular prenatal care. These mothers have fewer low-birthweight babies, and that reduces the number of children with short- and long-term disabilities and the need for costly health care. What's more, the larger the EITC benefit, the greater the positive effect: A \$1,000 increase in EITC reduced the rate of costly low-birthweight babies by 2–3 percent. Since low-birthweight babies are more likely to be covered by Medicaid, the return on public investment in EITC is even greater.<sup>5</sup>
- Children in EITC households are more likely to graduate from high school and college, giving them better lifetime income prospects. Again, a \$1,000 increase in benefits resulted in measurable improvements in student test scores and high school graduation rates. Since rates of high school achievement and enrollment in college are lower among low-income families, the EITC is an effective way to target funds for the greatest return on investment.<sup>6</sup>
- EITC families have greater food security and are able to increase expenditures for healthy food.
- EITC encourages work, especially for women, whose earnings not only help immediately but result in better retirement benefits due to increased Social Security contributions. The Congressional Budget Office estimated a 17 percent lifetime boost in earnings for less educated women due to EITC.<sup>7</sup>

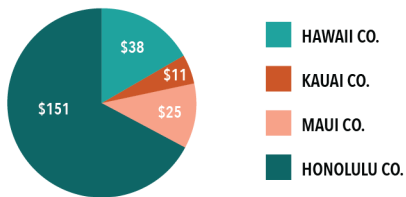
The EITC contributes to the economic health of communities, too. This is because lower-income families spend their EITC benefits as soon as they get them on food, school needs, and other essentials. These expenditures, in turn, support local merchants and jobs. In testimony before Congress, Mark Zandi, the chief economist for Moody's Analytics, reported that the EITC was among the most effective means of fiscal stimulus, providing \$1.24 in community benefit for every \$1 spent.<sup>8</sup>

The federal EITC was initially signed into law in 1975 and expanded several times since then. Republican lawmakers from Gerald Ford and Ronald Reagan to Paul Ryan have supported its pro-family work incentives, while Democrats have lauded its ability to reduce poverty and associated problems.

### Who benefits from the federal EITC in Hawai'i?

In 2015, nearly one in every four households in Hawai'i filed for the federal EITC, with claims amounting to more than \$230 million.\* These benefits helped families and the economies in all counties.

2015 FEDERAL EITC BENEFITS  
DISTRIBUTED BY COUNTY IN \$ MILLIONS



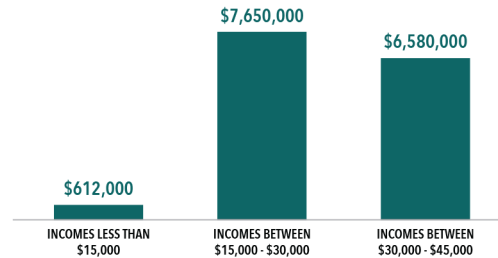
The median income for federal EITC households was \$14,418, and workers were most often employed in office and administrative jobs (17%), retail (16%), and sales (15%).

\* <https://tpc-eitc-tool.urban.org/>

### Who benefits from the state EITC in Hawai'i?

The state Department of Taxation reported that Hawai'i's EITC was claimed by 55,656 households and provided \$15.3 million in benefits in 2018, its first year.\*

HAWAII EITC BENEFIT  
BY HOUSEHOLD INCOME LEVEL



No other program information is available yet, but it is clear that because Hawai'i's EITC is not refundable like the federal EITC, the lowest-income working households were helped the least by the program.

\*[http://files.hawaii.gov/tax/stats/stats/act107\\_2017/act107\\_earnedincome\\_txcredit\\_2018.pdf](http://files.hawaii.gov/tax/stats/stats/act107_2017/act107_earnedincome_txcredit_2018.pdf)

In fact, the individual, social, and economic benefits are so compelling that some states have invested public dollars in outreach and tax preparation assistance, and some legislatures have passed laws that require state and local agencies to notify potentially eligible families about the program.<sup>9</sup> Twenty-nine states, the District of Columbia, and Puerto Rico have created EITC programs to supplement the federal program. Even local jurisdictions have created EITC programs, including New York City and Montgomery County, Maryland.<sup>10</sup>

## How EITC works

The EITC program provides unparalleled economic benefits to working families because it rewards work. The earned income limits for the federal EITC in 2018 went up to nearly \$55,000, depending on marital status and the number of children. Working households without children also benefit from EITC but at lower levels. The average EITC for households with children amounted to nearly \$3,200 in 2018 compared to only \$300 for families without children.

The federal EITC works by reducing the tax liability of eligible families but, importantly, it is a refundable tax credit. This means it not only decreases the taxes that eligible workers pay, but puts money into their pockets with a refund if the taxes they owe are less than the tax credits they have earned.

Some government programs provide benefits only to families with very low incomes, and their benefits stop abruptly if a family's income rises above the eligibility threshold. The EITC has the opposite effect. It encourages work and income stability because it increases with income growth (up to a maximum), and then phases out.

## Hawai'i's EITC

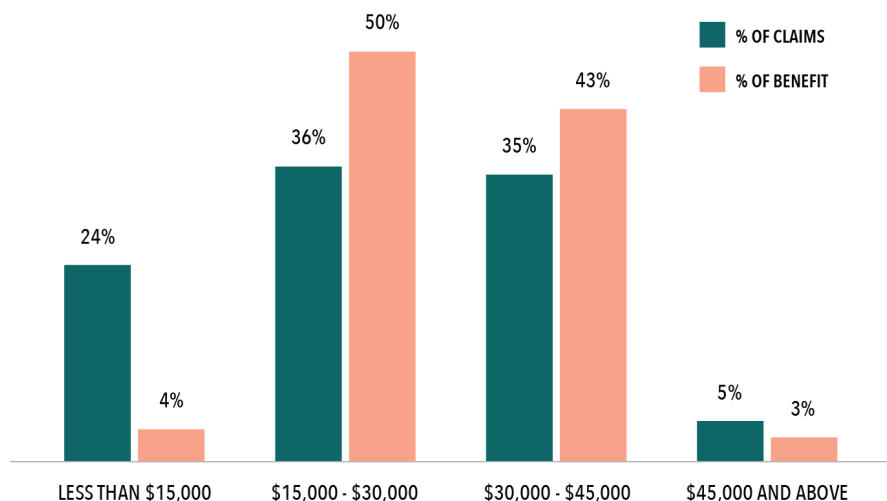
In 2017, Hawai'i passed legislation to create a state EITC.<sup>11</sup> The new law allowed qualified taxpayers to claim a state tax credit beginning in 2018. The state tax credit amounts to 20 percent of the federal EITC but, unlike its federal counterpart, Hawai'i's tax credit is not refundable. That is, if the filer owes less in taxes than the credit is worth, the state does not refund the difference to the taxpayer but carries it over to the following year, when it may not be useful either.

This flaw reduces the overall value of the tax credit by nearly half. The Institute on Taxation and Economic Policy (ITEP) estimated that for 2020, the state's nonrefundable tax credit would provide \$18.7 million in tax relief for low- to moderate-income Hawai'i families. A refundable tax credit would add an additional \$18.3 million in benefits for these struggling families. Applying Mark Zandi's economic multiplier (\$1.24 in total benefits for \$1 spent on EITC), a refundable Hawai'i EITC would add \$22.7 million in community benefits.

What's worse, by being nonrefundable, Hawai'i's EITC provides less benefit to the lowest-income households. The Department of Taxation's report on the state EITC's first year confirms this. The table below and graph (figure 1) on page 7 shows the very modest benefits Hawai'i's EITC offered households with the lowest incomes:<sup>12</sup>

Household Income	Average EITC Claim
Less than \$15,000	\$51
\$15,000 to \$30,000	\$380
\$30,000 to \$45,000	\$338
\$45,000 and above	\$140

## HAWAII EITC IN 2018: CLAIMS AND BENEFITS BY INCOME LEVEL



**Figure 1** shows comparative EITC benefit among eligible households. The lowest-income taxpayers received disproportionately little benefit from the state’s nonrefundable program. “Claims” means number of tax returns claiming the state EITC. “Benefit” means the dollar value of state EITC the taxpayer received.

Because Hawai‘i’s lowest income households are disproportionately made up of Native Hawaiian, Pacific Islander, and Vietnamese families, the EITC nonrefundability problem contributes to keeping more of these families in poverty. The same ethnic groups are also most likely to include children under the age of 18 in their households. This means our EITC is not able to target critical assistance to the children and youth who need it most.

The chart on page 8 provides examples of households of different sizes and income levels and the amount of state income taxes owed and tax credits they can use. It shows that families with the lowest incomes earn the largest EITC benefits, but, because they have little income they do not owe much in state income tax. As a result, their EITC benefit is more than needed to reduce their taxes to zero. Higher income households, on the other hand, can take full advantage of EITC benefits because they owe more in taxes.

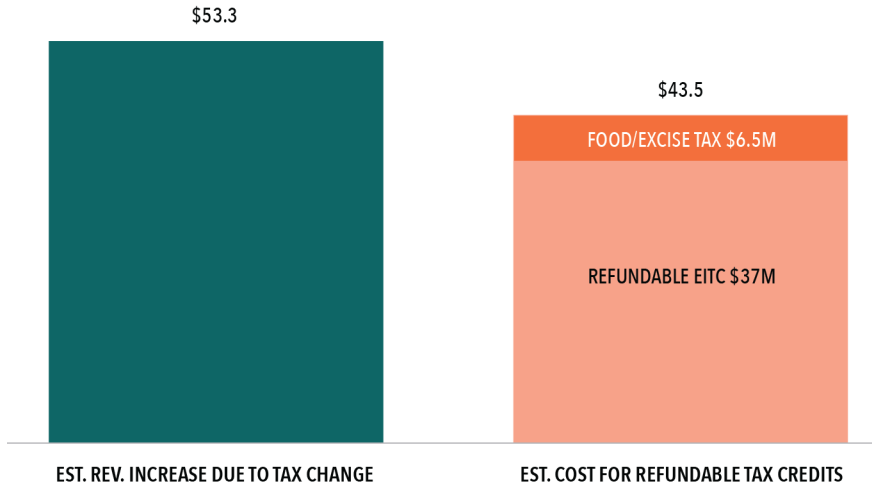
This example shows that the minimum wage and poverty-level households are able to use the state EITC to eliminate all or part of their state tax liability. However, a refundable EITC would give the lowest-income taxpayers, Households 1 and 2, a refund amounting to \$193 and \$581, respectively. Households 3 and 4 have higher incomes and owe more in state taxes. Because of that, they get the full benefit of the state EITC to reduce their tax obligation.

Hawai‘i deploys tax credits as a common tool to promote social welfare, environmental protection, and business activity. The great majority—70 percent of the tax credits distributed in 2017—were refundable.<sup>13</sup> Of these, \$66 million went to promote social welfare and \$153 million to encourage certain industries and economic activity.<sup>14</sup> Hawai‘i makes tax credits refundable for renewable energy technologies (\$83 million in 2017), motion picture and film production (\$62 million in 2017), and capital goods for depreciable business property (\$29 million in 2017).<sup>15</sup>

	<b>Household 1</b> Head of Household, 1 Child	<b>Household 2</b> Married, 2 children	<b>Household 3</b> Head of Household, 1 Child	<b>Household 4</b> Married, 2 children
Annual Income	\$21,008 (2018 min. wage @ \$10.10/hour)	\$28,870 (2018 poverty level)	\$31,200 (\$15/hour wage)	\$42,016 (2 adults earning min. wage)
Hawai'i Taxable Income (annual income after subtracting exemptions and deductions)	\$15,508	\$19,894	\$25,700	\$33,040
Applicable Hawai'i Income Tax	\$634	\$792	\$1,303	\$1,650
Refundable Tax Credits that reduce taxes:				
Food/Excise Tax Credit	(\$110)	(\$220)	(\$90)	(\$140)
Low-Inc. Renters Tax Credit	(\$100)	(\$200)	\$0 (Not eligible)	\$0 (Not eligible)
Taxes owed after subtracting Food/Excise and Renters Tax Credits	\$424	\$372	\$1,213	\$1,510
Hawai'i EITC (20% of federal EITC)	\$617	\$953	\$291	\$399
EITC applied to tax liability	(\$424)	(\$372)	(\$291)	(\$399)
Final State Tax Liability	\$0	\$0	\$922	\$1,111
Was all state EITC Used?	No	No	Yes	Yes
Additional benefit household would get if state EITC was refundable	\$193	\$581	0	0



**2020 ESTIMATED INCREASES:  
TAX REVENUE AND REFUNDABLE TAX CREDITS  
IN MILLIONS**



ITEP estimated that a refundable Hawai'i EITC for 2020 would cost a total of \$37 million: \$18.7 million by reducing state tax liability plus \$18.3 million by making the balance earned refundable. This cost should not be a barrier. In the same bill that created the state EITC, the legislature amended the income tax structure, reinstating the three top tax brackets for high-income taxpayers. The State Council on Revenues estimated that these changes would boost tax collections by \$53.3 million in 2020, going up to \$64.7 million in 2024.<sup>16</sup> These gains far exceed the estimated \$37 million needed for a refundable state EITC in 2020. (The enhanced revenue was also intended to offset an increase in the state's refundable food/excise tax credit that was addressed in the same Act. The food/excise tax credit increase was estimated to cost \$6.5 million.)

Finally, the legislature needs to eliminate the "sunset" provision to ensure that Hawai'i continues to benefit from the state EITC. The authorizing legislation for this tax credit specified that it cannot be applied to taxable years after December 31, 2022. Providing an end date for a new program or tax credit is not unusual. The legislature often puts such provisions in place to ensure that new initiatives are reviewed for effectiveness. However, across the nation EITC has already been thoroughly studied and consistently deemed exemplary.

## Conclusion

The success of the federal Earned Income Tax Credit is so striking that most states and some local governments have implemented similar programs. Hawai'i created a state EITC in 2017 but without making it a refundable credit. This failure to fully embrace the potential of EITC reduces its effectiveness for tens of thousands of the struggling working families it was intended to help. It also significantly limits the economic stimulus and job creation roles that the EITC can play. Finally, the 2017 legislation will terminate after 2022 if not amended by the legislature to eliminate the "sunset" provision. We should not delay changing the state EITC to realize all its benefits for the people of Hawai'i.

**Now that Hawai'i's Earned Income Tax Credit is in place, it is time to**

- **Make the state EITC refundable, and**
- **Remove the "sunset" provision that would end it after 2022.**

## Endnotes

- 1 "Briefing Book," Tax Policy Center, <https://www.taxpolicycenter.org/briefing-book/how-does-earned-income-tax-credit-affect-poor-families>
- 2 "Policy Basics: The Earned Income Tax Credit," December 10, 2019, Center on Budget and Policy Priorities, <https://www.cbpp.org/research/federal-tax/policy-basics-the-earned-income-tax-credit>
- 3 "Tax Credits are Smart Policy Investments for a Healthier New Mexico," February 20, 2019, New Mexico Voices for Children, <https://www.nmvoices.org/archives/12703>
- 4 "The Earned Income Tax Credit, Poverty, and Health," October 4, 2018, Health Affairs, <https://www.healthaffairs.org/doi/10.1377/hpb20180817.769687/full/>
- 5 "Access in Brief: Pregnant Women and Medicaid," November 2018, Medicaid and CHIP Payment and Access Commission, <https://www.macpac.gov/wp-content/uploads/2018/11/Pregnant-Women-and-Medicaid.pdf>
- 6 "More Hawai'i High Schoolers Graduating, But College-Going Rate Doesn't Budge," April 3, 2019, Hawai'i News Now, <https://www.hawaiinewsnow.com/2019/04/03/hawaiis-graduation-rate-higher-than-ever-college-going-rate-doesnt-budge/>
- 7 "The Earned Income Tax Credit and Expected Social Security Retirement Benefits among Low-Income Women," March 2012, Working Paper Series, Congressional Budget Office, Washington, DC, [https://www.cbo.gov/sites/default/files/cbofiles/attachments/WorkingPaper2012-06-EITC\\_and\\_SS\\_Retirement\\_Benefits.pdf](https://www.cbo.gov/sites/default/files/cbofiles/attachments/WorkingPaper2012-06-EITC_and_SS_Retirement_Benefits.pdf)
- 8 Zandi, Mark, "Bolstering the Economy: helping American Families by Re-authorizing the Payroll Tax Cut and UI Benefits," February 7, 2012, Written Testimony before the Joint Economic Committee of Congress, <https://www.economy.com/mark-zandi/documents/2012-02-07-JEC-Payroll-Tax.pdf>
- 9 Ibid.
- 10 Ibid.
- 11 "A Bill for an Act Relating to Taxation," House Bill 209, Conference Draft 1, 2017, State of Hawai'i Legislature, [https://www.capitol.hawaii.gov/session2017/bills/HB209\\_CD1\\_.htm](https://www.capitol.hawaii.gov/session2017/bills/HB209_CD1_.htm)
- 12 "Annual Earned Income Tax Credit Report Required by Act 107, SLH 2017 for Tax Year 2018," December 2019, Hawai'i Department of Taxation, [http://files.hawaii.gov/tax/stats/stats/act107\\_2017/act107\\_earnedincome\\_txcredit\\_2018.pdf](http://files.hawaii.gov/tax/stats/stats/act107_2017/act107_earnedincome_txcredit_2018.pdf)
- 13 This figure does not include \$19 million for tax credits awarded in 2016 or programs that had expired but were still payable.
- 14 "Tax Credits Claimed by Hawai'i Taxpayers, Tax year 2017," December 2019, Hawai'i Department of Taxation, <http://files.hawaii.gov/tax/stats/stats/credits/2017credit.pdf>
- 15 Ibid.
- 16 Letter to Governor Ige, September 10, 2019, Hawai'i Council on Revenues [http://files.hawaii.gov/tax/useful/cor/2019gf08-29\\_with0910\\_Rpt2Gov.pdf](http://files.hawaii.gov/tax/useful/cor/2019gf08-29_with0910_Rpt2Gov.pdf)

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