



Issue Brief

Budget & Tax Policy Initiative



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A STRATEGY FOR INCOME TAX REFORM IN ILLINOIS

The fundamental fiscal challenge for state government in Illinois is how to generate revenue to meet both ongoing obligations and emerging needs without putting an unfair tax burden on low- and middle-income families. Voices for Illinois Children has proposed a policy strategy for fiscal reform that links a higher state income tax to a reform package with three components: a larger personal exemption, which would benefit all households and would make the individual income tax structure more progressive; a more generous state earned income tax credit targeted at the working poor; and a state-level child tax credit to provide additional relief for both low-income and middle-income families. This fiscal reform strategy would generate new revenue and improve tax fairness at the same time. The amount of revenue generated and the effects on taxpayers would vary — depending on the income tax rates, personal exemptions, and targeted tax credits in specific reform plans.¹

Personal exemption: When the state income tax was first enacted in 1969, the personal exemption was \$1,000. For a family of four, exemptions amounted to \$4,000, which was then about the same as the federal poverty level (FPL) for a two-parent family with two children. Exemptions for a family of four now total \$8,000, which was less than 40 percent of FPL in 2007. Any increase in the individual income tax rate should be linked to a higher personal exemption that is also indexed to inflation. Substantially raising the personal exemption would benefit all households, but its impact would be greatest for those at lower income levels.

Earned income tax credit: The federal earned income tax credit (EITC), first enacted in 1975, has become an extremely important policy tool for reducing poverty among low-income families with children. A distinctive feature of the EITC is that it is “refundable.” That is, if the amount of the credit exceeds a family’s income tax liability, the Internal Revenue Service will refund the difference. The state EITC in Illinois is set at only 5 percent of the federal tax credit. Among the states with their own EITCs for tax year 2007, none offers a smaller credit. Increasing the Illinois EITC would provide additional tax relief for those who need it most — the working poor.

Child tax credit: The federal child tax credit (CTC), instituted in 1997 and expanded in 2001 and 2003, is targeted more broadly than the EITC. Working families with earnings above \$11,750 can receive a partially refundable credit of up to \$1,000 per qualifying child under age 17. The CTC is phased out beginning at the \$110,000 income level for married couples and at \$75,000 for single heads-of-household. If Illinois were to adopt a state version of the child tax credit, it could provide significant tax relief to both low-income and middle-income families.

¹ For a discussion of several alternative reform plans, see “Generating New Revenue, Improving Tax Fairness: A Policy Strategy for Income Tax Reform in Illinois” (Voices for Illinois Children, June 2007).

Effects on families: Table 1 presents an example of estimated changes in state income tax liability for married couples with two children under a tax reform package consisting of a tax rate of 5 percent, a personal exemption of \$5,100 (150% of the federal exemption), a state EITC set at 20 percent of the federal EITC, and a state child tax credit set at 30 percent of the federal CTC. A family with an income of \$20,000 (just below poverty level) would have no state income tax liability and would be eligible for refundable tax credits totaling more than \$1,200. A comparable family at the \$40,000 income level would have their taxes cut in half. For a family at \$60,000 (close to the median family income in Illinois), the tax liability would still be lower than under the current system.

Table 1: Estimated Changes in State Income Tax Liability for Married Couple with Two Children*

Earned income	Current income tax liability	New tax liability	Change in tax liability
\$20,000	\$152	-\$1,203	-\$1,355
40,000	960	380	-580
60,000	1,560	1,380	-180
80,000	2,160	2,380	+220
100,000	2,760	3,380	+620

* Income tax at 5%, personal exemption at \$5,100, state EITC at 20% of federal EITC, state child tax credit at 35% of federal CTC.

Revenue estimates: Table 2 presents estimates of additional state revenue for fiscal year 2007 under the example outlined above. Net revenue with the individual income tax at 5 percent and the tax relief package would have been about \$4.2 billion. A corresponding increase in the corporate income tax to 8 percent would have brought total new state revenue to \$5.3 billion. An income tax increase with a phase-in period of several years could be accompanied by incremental changes in the personal exemption and the targeted tax credits.

Table 2: Estimates of Additional State Revenue in Fiscal Year 2007 (in \$ millions)

Individual income tax at 5%	\$6,695
Personal exemption at \$5,100	-1,834
Earned income tax credit at 20% of federal	-240
Child tax credit at 30% of federal CTC	-450
Net revenue from individual income tax	4,171
Corporate income tax at 8%	1,167
Total new state revenue	5,338

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