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# THE CASE FOR CREATING A GRADUATED INCOME TAX IN ILLINOIS

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Founded in 2000, the Center for Tax and Budget Accountability is a non-profit, bi-partisan research and advocacy think tank committed to ensuring that tax, spending and economic policies are fair and just, and promote opportunities for everyone, regardless of economic or social status.

CTBA uses a data-focused, bipartisan approach to work in partnership with legislators, community groups and other organizations to help change both public policy and perceptions.

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## 1. Introduction

Illinois historically has been one of the most unfair taxing states in the nation.<sup>1</sup> Sure, in January, 2012, the Governor signed into law a bill designed to make the state's tax system somewhat fairer, by increasing both the Illinois Earned Income Tax Credit and standard personal income tax exemption.<sup>2</sup> While this represents a step in the right direction, it is not the type of structural reform needed to create true tax fairness. And Illinois' continuing failure to create tax fairness should concern everyone, because this failure has consequences beyond being poor tax policy. Indeed, the data indicate that Illinois' lack of tax fairness has both contributed materially to the state's ongoing General Fund budget deficits and harmed Illinois' private sector economy.

Consider that the Great Recession officially ended over two years ago in June, 2009. During the "recovery" that has followed, job growth in Illinois has been woefully inadequate. So woeful in fact that, through March 31, 2011, total non-farm employment in the state was 304,400 jobs less than when the Great Recession started in December of 2007, and over 580,000 jobs less than at Illinois' prior employment peak in November of 2000.<sup>3</sup> Given that reality, now is precisely the time that investments by state government in everything from infrastructure, to education, healthcare, and human services are most needed, both to maintain private sector spending crucial to creating jobs and to meet growing demand for public services.<sup>4</sup> But state government's ability to make the investments needed to help create jobs and meet demand for services remains severely curtailed by ongoing, structural deficits that plague the Illinois General Fund. These deficits are due in large part to the state's unfair imposition of tax burden on Illinois families.

On the demand side, Illinois' unfair tax policy constrains long-term economic growth in the state's private sector by over taxing our best consumers, low and middle income families. Over taxing low and middle income families directly reduces consumer spending, because overtime their income in real, inflation adjusted terms has been flat or declining.<sup>5</sup> Since these families do not really have the ability to save, additional tax dollars they pay come directly out of what they otherwise would spend in their local economies.<sup>6</sup> This is a problem, because the biggest driver of the private sector economy is consumer spending, which accounts for over 66 percent of all economic activity.<sup>7</sup>

State government's task of promoting private sector growth while overcoming fiscal shortfalls is difficult, and ultimately will require implementing a number of varying initiatives. No magic silver bullet will resolve all the fiscal and employment challenges facing Illinois today. That said, there is one long-term, structural policy change that would simultaneously stimulate job growth in the state, tax people more fairly and reduce Illinois' General Fund deficits: creating a graduated rate structure for the Illinois individual income tax.

## 2. Key Findings

- **Current Illinois tax policy is neither fair to taxpayers nor designed to sustain funding current service levels into the future.**
- **One key reason Illinois tax policy fails both the fairness and sustainability tests is that overall the system fails to impose tax burden in a manner that corresponds to ability to pay.**
- **A tax system must be progressive to impose tax burden in a manner that corresponds to ability to pay. A progressive tax system imposes a greater tax burden on affluent than on middle to low income earners, when tax burden is measured as a percentage of income. This is needed to track ability to pay, given the significant growth in income inequality over the last 30 years. Because it tracks ability to pay, progressive taxation has traditionally been the cornerstone of fair taxation under capitalist tax policy generally and in America specifically. Far from being progressive, Illinois' tax policy is regressive, assessing much higher**

overall tax burdens as a percentage of income on low and middle-income families than on affluent families. Indeed, Illinois has the third highest tax burden on low income families in the nation.<sup>8</sup>

- The state constitutional prohibition on implementing a graduated rate structure in the Illinois individual income tax<sup>9</sup> is one of the primary reasons Illinois tax policy is regressive overall, and hence unfair. Not having a graduated rate structure for its individual income tax also makes Illinois a tax policy outlier. Of the 41 states with an individual income tax, all but seven have graduated rate structures.<sup>10</sup>
- Given the significant growth in income inequality over the last 30 years, Illinois’ failure to implement a graduated individual income tax rate structure has both harmed the state’s private sector job growth and contributed substantially to Illinois’ ongoing structural deficits in its General Fund.
- If Illinois amended its constitution to allow implementation of a graduated rate structure for the individual income tax, that structure could be designed in a way that would:
  - cut overall state income tax burden for 94 percent of all taxpayers—that means on average, taxpayers with under \$150,000 in annual base income would receive a tax cut;
  - raise at least \$2.4 billion annually in new revenue to help eliminate ongoing structural deficits in the General Fund;
  - despite shifting tax burden to affluent taxpayers, nonetheless keep the effective<sup>11</sup> state income tax rate for millionaires at just 4.3 percent; and
  - stimulate the growth of at least 36,000 jobs in the state’s private sector through enhanced public and consumer spending.

### 3. Illinois’ Lack of a Graduated Income Tax Rate Structure is Unfair to Taxpayers, Contrary to Sound Tax Policy and Makes Illinois a Tax Outlier.

A graduated income tax rate structure helps create a progressive and hence fair tax system by placing a greater tax burden on affluent families than on low and middle income families, when tax burden is measured as a percentage of income. True, the legislature and governor took some steps to make tax policy fairer in January 2012 when they modestly increased both the State’s Earned Income Tax Credit and standard exemption.<sup>12</sup>

**Figure 1**  
**Illinois State & Local Taxes Paid as a Share of Family Income for Non-Elderly Taxpayers<sup>13</sup>**

Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
					Next 15%	Next 4%	Top 1%
Income	Less than \$18,000	\$18,000 – \$36,000	\$36,000 – \$58,000	\$58,000 – \$95,000	\$95,000 – \$196,000	\$196,000– \$500,000	\$500,000 or more
Average Income in Group	\$10,100	\$26,600	\$47,000	\$74,700	\$128,900	\$300,700	\$2,084,700
Sales & Excise Taxes	6.9%	5.5%	4.4%	3.6%	2.7%	1.7%	0.8%
Property Taxes	4.8%	3.6%	3.7%	3.7%	3.9%	3.1%	1.5%
Income Taxes	2.0%	3.2%	3.9%	4.0%	4.1%	4.1%	4.2%
<b>TOTAL TAXES</b>	<b>13.7%</b>	<b>12.3%</b>	<b>12.0%</b>	<b>11.4%</b>	<b>10.7%</b>	<b>8.9%</b>	<b>6.5%</b>
Federal Deduction Offset	-0.0%	-0.1%	-0.4%	-0.7%	-1.1%	-0.8%	-1.2%
<b>TOTAL AFTER OFFSET</b>	<b>13.7%</b>	<b>12.2%</b>	<b>11.6%</b>	<b>10.7%</b>	<b>9.5%</b>	<b>8.0%</b>	<b>5.3%</b>

Source: Institute on Taxation & Economic Policy, *Who Pays? A Distributional Analysis of Tax Systems in All 50 States*, p. 42, Third Edition, November 2009. Note: This table shows 2007 data updated to reflect permanent changes in Illinois tax law enacted through January, 2012.

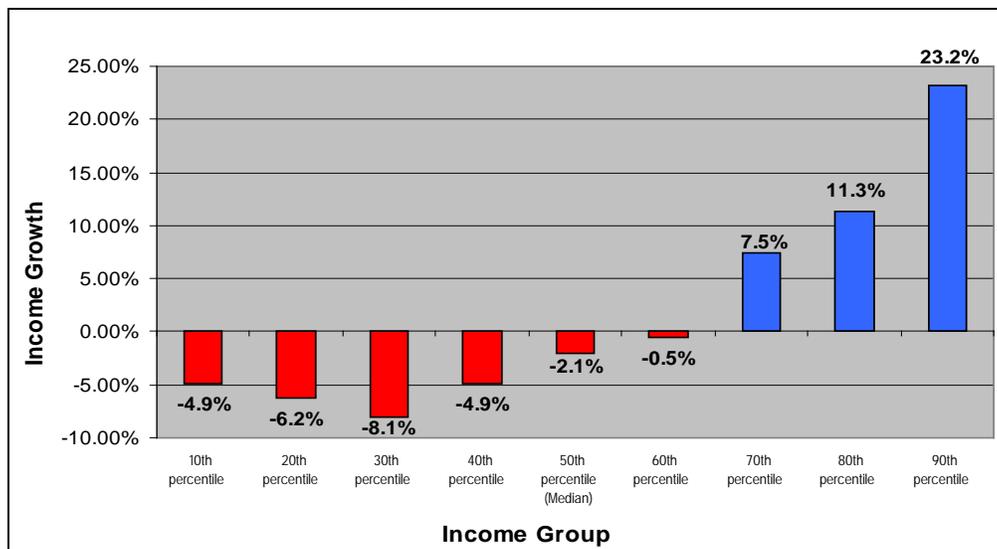
That said, overall the Illinois tax system remains very regressive, reserving the greatest tax burdens for low and middle income families. Indeed, Illinois currently has the third highest tax burden for low income families of all the states.<sup>14</sup> As

Figure 1 shows, poor, low and middle income families in Illinois have state tax burdens that are more than double the tax burden of high income earners.

As it turns out, being regressive makes Illinois tax policy both unfair and unsound. First, consider fairness. Who do you think said “The subjects of every state ought to contribute toward the support of government as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state?” Why, that was Adam Smith, the father of capitalism, in his seminal work The Wealth of Nations.<sup>15</sup> Smith specifically endorsed the proposition that tax policy should “remedy inequality of riches as much as possible, by relieving the poor and burdening the rich.”<sup>16</sup>

Smith championed graduated taxation because he believed the affluent would benefit disproportionately from economic growth under capitalism.<sup>17</sup> Figure 2, which shows how much income inequality grew in Illinois from 1979-2010, demonstrates that Smith’s conjecture was spot on. In fact, the bottom 60 percent of income earners in Illinois actually took home less money on an inflation-adjusted basis in 2010 than they did in 1979.<sup>18</sup>

**Figure 2**  
**Change in Inflation Adjusted Real Wages in Illinois, 1979-2010**



Source: Center for Tax and Budget Accountability analysis of Current Population Survey data, adjusted for inflation using the CPI-U-RS data from the State of Working America, Economic Policy Institute, 2011.

National income trends are no better. Data compiled by Professors Piketty and Saez show that from 1973-2008, 120.6 percent of all family income growth in the nation went to the wealthiest ten percent of families. So, if over 100 percent of the income growth went to the top 10 percent, that means everyone else lost income. Indeed, the real family income of the 90 percent of Americans who constitute the vast majority of the country was lower in 2008 than in 1973.<sup>19</sup> Clearly, then, to be fair, taxes ought be focused on those at the top of the income ladder, who would pay from their growing wealth, rather than those at the middle and bottom, who have declining real incomes over time.

For two key reasons, among the different methods of taxation (excise, income, sales, property, etc.) generally available to state and local governments, the income tax is the one used to create fairness. First, the income tax is inherently the fairest tax because it is the only tax which increases or decreases automatically in accordance with a taxpayer's ability to pay. If a taxpayer receives a raise, her income tax liability will increase. If on the other hand she loses her job, her income tax liability will decrease. **No other tax automatically adjusts its burden in accordance with a taxpayer's ability to pay.**

But that is not the only, nor even most important “fairness” role for the income tax to play in a state tax system. Indeed, the income tax can be designed to offset the inherent regressivity of all the other taxes (property, sales and excise) imposed by state and local governments. That’s because, unique among the different taxes, an income tax can have a graduated rate structure—that is, impose higher marginal tax rates on individuals with higher incomes. Implementing a thoughtful, graduated income tax can thereby make a state’s overall tax burden fair—or at least fairer than it would be without a graduated income tax rate structure.

Using a graduated income tax rate structure to make tax policy fair has a venerable tradition in America that crosses ideological lines. When the federal income tax was reestablished in 1913—during the era of the great robber barons—it only applied to the richest four percent in America.<sup>20</sup> Republican Presidents Nixon and Reagan both advocated strongly for creating tax fairness through progressive taxation. Most recently, Republican President George W. Bush specifically endorsed the concept of progressive taxation in his 2001 budget proposal to Congress, which emphasized that his tax proposal “gives the lowest income families the greatest percentage reduction. Indeed, higher income individuals will pay a higher share of taxes after (the president’s) plan takes effect.”<sup>21</sup>

In that same budget proposal, George W. Bush justified his desire to make taxes fairer by stressing it was “an unfortunate quirk of the present tax code that many low-income families are now facing higher marginal tax rates than wealthy individuals.”<sup>22</sup> In Illinois, regressive taxation is no mere quirk, it instead constitutes a fundamental flaw that has created a tax system that is unfair to the vast majority of taxpayers and contributes significantly to the state’s ongoing General Fund deficits.

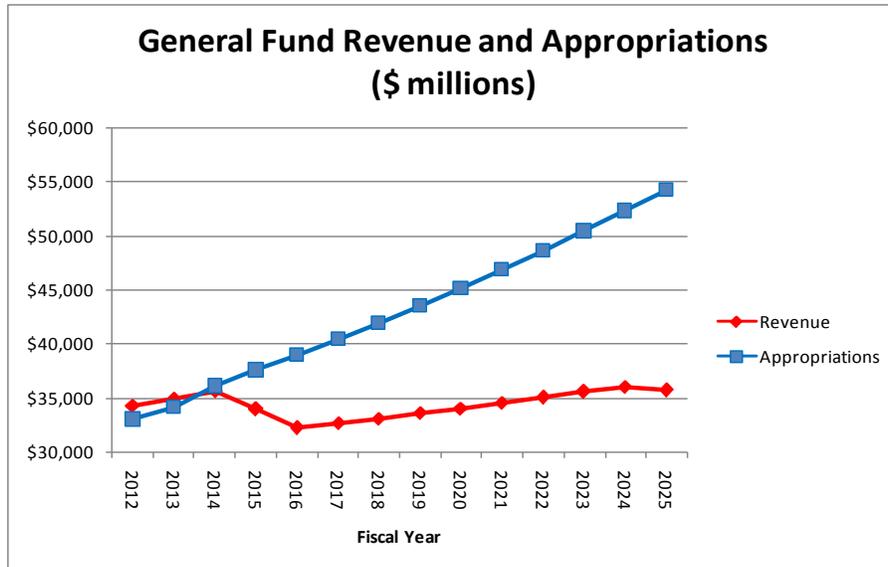
Moving from the federal to the state level does not change the clear preference for creating tax fairness with graduated income tax rates. In fact, the vast majority of states that have an individual income tax have a graduated rate structure. Currently 41 states assess an individual income tax, and of the 41, 34 states or 83 percent of the total have a graduated rate structure.<sup>23</sup> That leaves Illinois as a tax outlier, joining only six other states in having one flat income tax rate apply to all individuals, regardless of annual earnings. The bottom line is clear: Illinois’ current unfair tax system runs contrary to longstanding federal and state tradition, and even runs afoul of text book tax policy, which cautions that “progressive taxation reduces inequalities. Regressive taxation increases them.”<sup>24</sup>

So why has Illinois tax policy remained contrary to the principles of fair taxation and the long standing, historic and broad based ideological support for using graduated income tax rates? **The primary reason is simple: the Illinois Constitution prohibits lawmakers from setting marginal rates at different amounts for different levels of income, because it mandates a flat tax rate across all income brackets.**<sup>25</sup> Hence, to create a graduated rate structure in its individual income tax, Illinois must amend its constitution.

#### **4. Lack of a Graduated Income Tax Rate Structure Contributes to Ongoing Budget Deficits**

From a fiscal standpoint, focusing tax burden on low- and middle-income families also makes no sense, because it fails to respond to how economic growth is actually distributed across different income brackets. Review the long-term growth in income inequality highlighted previously in Figure 2. Simply put, focusing taxes on a demographic that loses income in inflation adjusted terms over time necessarily means revenue collection will not keep pace with the economy, because taxation is being focused where the economy is contracting not where it is expanding.<sup>26</sup> That is why the lack of fairness in the state’s income tax helps contribute to ongoing structural deficits in the Illinois General Fund, as depicted in Figure 3.

**Figure 3**  
**Illinois General Fund Structural Deficit**



Source: CTBA Structural Deficit Model is based on data from the Commission on Government Forecasting and Analysis, Governor’s Office of Management and Budget and the Bureau of Labor Statistics. It assumes continuation of current law and adjusts solely for inflation and population growth, and historic revenue and economic growth.

As Figure 3 shows, adjusting solely for inflation and population growth, and assuming historic revenue and economic growth rates, revenues under Illinois’ current, regressive tax system will not grow at rates sufficient to maintain current service levels into the future.<sup>27</sup> So, without adding or expanding even one public service, Illinois will nonetheless experience annual General Fund deficits because its tax system is not designed to work in a modern economy.

In simple terms, the structural deficit means the cost of providing public services in Illinois will grow with the economy and population over time, but state revenues will not. One of the main reasons state revenue growth does not track population and economic growth is Illinois focuses its revenue collection on a diminishing portion of the economy—the incomes of low and middle income families, which are flat or declining in real terms over time. For state revenue to grow with the economy over time, tax policy has to respond to actual economic growth trends. That means focusing taxes on the top ten percent of income earners, who have collectively received all real income growth in the nation since 1973, as shown in the study on income inequality by Piketty and Saez referenced in Section 3 above.

## **5. Lack of a Graduated Rate Structure Hurts the Illinois Economy**

Illinois’ regressive tax policy also hurts the state’s private sector economic growth in two key ways. First, the structural deficit in large part created by regressive tax policy prevents the state from making investments in infrastructure, transit, education and other priorities that are essential for Illinois to remain competitive in a global economy.

Second, regressive tax policy directly reduces consumer spending in Illinois. That is a huge problem, since roughly two-thirds of all economic activity is consumer spending.<sup>28</sup> The best consumers are low and middle income families because—as clearly illustrated in Figure 2— they don’t earn enough to save. In economic terms, this means they have a high “marginal propensity to consume”. That simply means they are much more likely to spend rather than save every additional dollar received. Hence, as low and middle income families gain more income, they spend it, and in the local economy to boot.<sup>29</sup> That is why tax relief targeted to middle and low income families gets spent, which in turn creates

jobs.<sup>30</sup> Modestly increasing taxes on affluent folks, on the other hand, does not materially reduce their spending, at least according to Nobel Prize winning economist Joseph Stiglitz.<sup>31</sup> That's because affluent families enjoy such a significant portion of all income growth that they have a very low marginal propensity to consume. Yet, contrary to this basic principle, Illinois imposes a significant tax burden on low and middle income families, thereby hurting the economy by reducing the amount of money these families, our best consumers, actually have to spend.

Moreover, there is clear, data-based evidence which shows that imposing high marginal state income tax rates on the wealthy does not impede state economic growth over the long-term. A recent study published by the Institute on Taxation and Economic Policy (ITEP), reviewed how the nine states with the highest marginal individual income tax rates compared to the nine states with no individual income tax in the following three, core economic indicators from 2001 through 2010: per capita real gross state product growth; real median income growth; and average annual unemployment rate.<sup>32</sup> The high individual income tax states covered in the study are California, Hawaii, Maine, Maryland, New Jersey, New York, Ohio, Oregon and Vermont. The states without a broad-based individual income tax are Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington and Wyoming. Over the period studied, the high individual income tax states realized greater growth in real, per capita gross state product than their non-tax peers (10.1% to 8.7%), significantly lower loss in real median household income (a decline of -0.7% to -3.5%) and an identical average annual unemployment rate of 5.7 percent).

At this juncture in time, Illinois' refusal to change its unfair tax policy that both diminishes consumer spending and forces state budget cuts is particularly problematic. As of August, 2011, Illinois still had not replaced the over 342,000 non-farm jobs it lost during the Great Recession. Truth be told, the state never recovered all the nonfarm jobs it lost during the recession of 2001.<sup>33</sup> Cutting state General Fund spending on core services like education and caring for the developmentally disabled, for instance, can be expected to harm the private sector's ability to replace those lost jobs.

Mark Zandi, the chief economist at Moody's.com, explains why such public spending cuts will hurt private sector job growth. He developed a simple metric for determining how public expenditures create a positive, private economic multiplier that generates more than a dollar-for-dollar benefit. It works like this. When state government pays the salary of a social worker or invests in a new road or in bridge construction, it initially stimulates the economy by expending revenue for work and economic activity that otherwise would not take place. The individuals who receive this revenue from the state in the form of salary or other payments then spend some of the money they earn on other purchases in the economy, such as food, clothing or car repairs. Hence, a portion of the initial state investment made on say, construction, becomes additional purchases in other sectors. One person's spending becomes another's income, who in turn spends that income on other purchases in the local economy and so on.

Zandi found that historically, every dollar spent on core public services like education, healthcare, caring for individuals with mental health concerns or developmental disabilities or providing child care, generates a positive multiplier of 1.36. That means for every dollar spent by the state, Illinois' private sector economy gets a benefit of \$1.36. Meanwhile tax relief targeted to low and middle income families should generate a multiplier of roughly 1.03. Taken together, the additional consumer and state spending that would result from Illinois' tax policy shifting to the graduated individual income tax rate structure outlined in Figure 7 below, should generate at least 36,000 private sector jobs.<sup>34</sup>

The flip side of the positive multiplier created by using a graduated individual income tax rate structure to maintain public spending on core services is the negative impact of cutting state spending. In other words, if making \$9 billion in expenditures on critical services can be expected to generate \$12.24 billion of private sector economic activity (\$9 billion multiplied by 1.36), then balancing the budget by cutting that amount of spending would hurt the economy by a similar multiple. For more information on how this works, please see our "Moving Forward" report, available online at [www.ctbaonline.org](http://www.ctbaonline.org).

Given the current economic context, now is precisely the right time to increase tax revenue with a graduated income tax focused primarily on the top ten percent of income earners, as opposed to reducing the state's budget deficit through significant service cuts. Simply put, while maintaining public service expenditures by increasing annual revenues

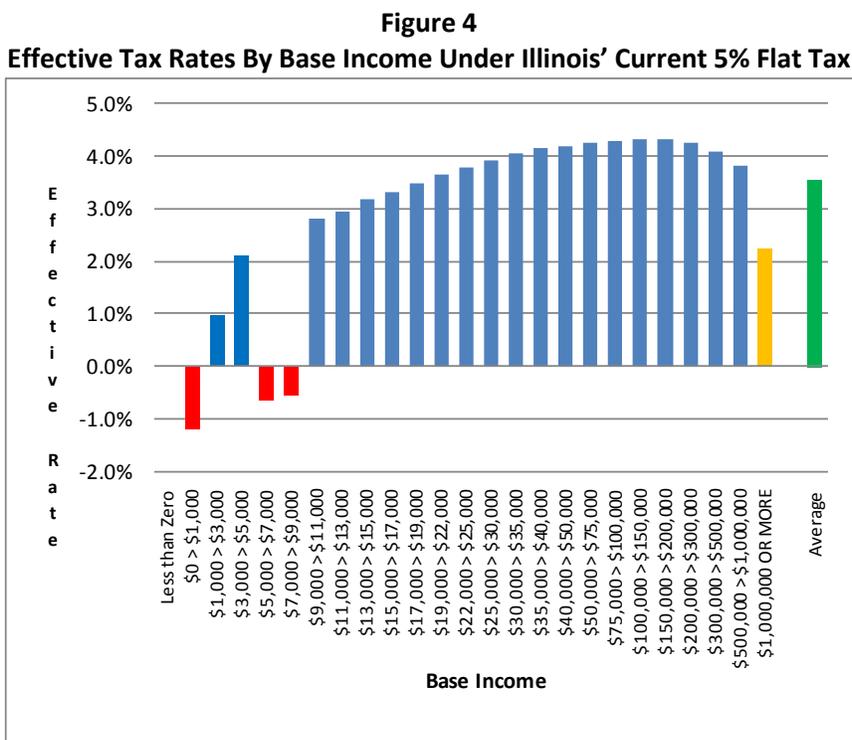
through a graduated income tax focused on top income earners can be expected to create private sector jobs, cutting state spending on core services can be expected to cause Illinois to lose tens of thousands of private sector jobs.<sup>35</sup>

## 6. The January 2011 Tax Increase Did Not Create Fairness

In January 2011, Illinois increased its individual income tax rate from three percent to five percent.<sup>36</sup> However, that tax increase did not make the state’s individual income tax any fairer.<sup>37</sup> The key reason for this, of course, is the constitutional mandate that Illinois be limited to one, flat income tax rate.

But how could having one rate that applies to everyone contribute to regressivity? The answer is simple. Most taxes imposed by state and local government, like sales, excise and property, are inherently regressive, that is, take a greater share of the earnings of low to moderate income families than of affluent families. Creating a graduated rate structure for the Illinois income tax is one of the few strategies available to counteract the natural regressivity of most taxes. Illinois is denied this fundamental tax fairness tool by a state constitution that requires one flat income tax rate for all taxpayers.

Moreover, focusing on statutory marginal income tax rates very much misses the point when it comes to assessing actual tax burden. That’s because the best way to analyze the relative tax burdens imposed by an income tax is to focus on the “effective tax rate” paid—that is, the actual percentage of base income a taxpayer pays in state income taxes, after accounting for all applicable deductions, offsets, credits and exemptions.



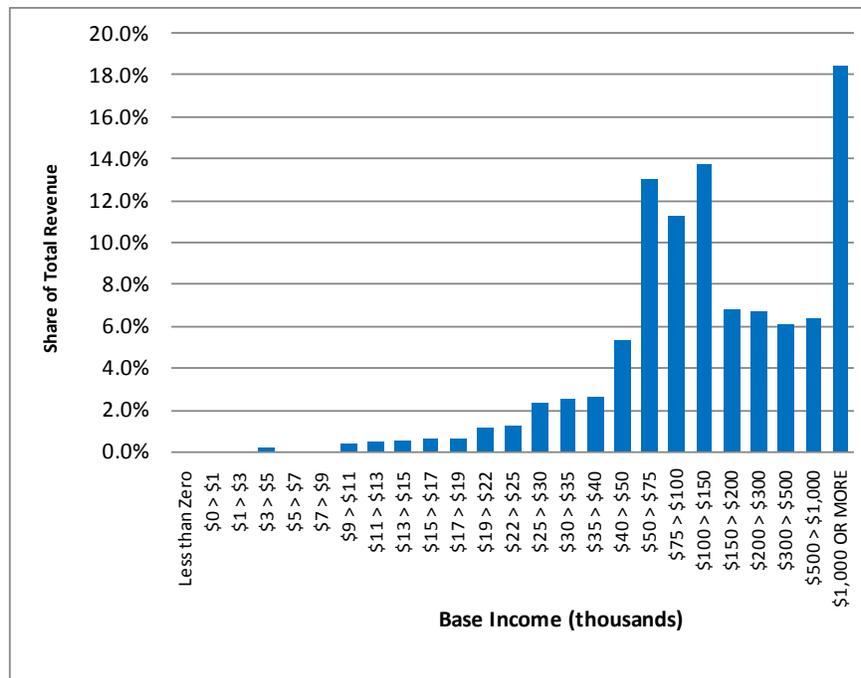
Source: 2007 Illinois Department of Revenue detailed income tax data, calibrated through 2009 and adjusted for changes in Illinois tax law passed in 2011.

Figure 4 shows that under Illinois’ current system, some of the lowest effective income tax rates are reserved for millionaires.<sup>38</sup> As Figure 4 illustrates, Illinois millionaires are subject to a very low effective state income tax rate of just 2.1 percent.<sup>39</sup>

Indeed, millionaires in Illinois pay an effective state income tax rate which is less than the effective income tax rate paid by individuals earning just \$9,000 - \$11,000 annually, and about half the effective rate paid by the average Illinois taxpayer.<sup>40</sup> This, despite the fact that real incomes are declining over time for the vast majority of low to middle income taxpayers, while growing substantially for millionaires.

Figure 5 shows the share of overall state revenue from the individual income tax paid by taxpayers in each income bracket under the state’s current five percent flat tax. As revealed in Figure 5, despite paying a very low effective state income tax rate of 2.1 percent, the 28,999 Illinois millionaires in 2007 (just 0.48 percent of all Illinois tax filers), nonetheless account for \$2.8 billion or 18.44 percent of the state’s total \$14.9 billion in individual income tax revenue. The reason for this is not that their tax burden is high, far from it, but rather the significant growth in income inequality that has occurred over the last 30 odd years.

**Figure 5**  
**Share of Total Tax Revenue Paid by**  
**Base Income with 5 Percent Flat Tax**



Source: 2007 Illinois Department of Revenue detailed income tax data, adjusted to account for the 2011 changes in Illinois tax law.

**7. A Well Designed Graduated Income Tax Rate Structure Could Reduce Taxes for 94 Percent of Illinois Taxpayers and Raise at Least \$2.4 Billion more in Revenue than the Current Five Percent Flat Tax**

If Illinois passed a constitutional amendment permitting the creation of a graduated income tax rate it could structure those rates in a number of different ways. For instance, if Illinois were to adopt the same graduated income tax rate structure as Iowa, Illinois would raise \$6.3 billion more in revenue than it does from its current five percent flat rate, while 54 percent—over half—of all taxpayers would pay less in state income taxes.<sup>41</sup>

Figure 6 shows how Illinois would fare if it adopted the graduated individual income tax rate structures of some other states, as well as the graduated rate structure recommended in this study. In this analysis CTBA uses the deductions, credits, etc., available under Illinois law, not the other states from which graduated income tax rate structures are taken, to create the most accurate picture of the impact of applying said various rate structures in Illinois. In other words, all CTBA changed was the rate structure—to see what the rate structures of different states would generate in Illinois, given our state’s existing deductions, credits, etc. Note that, in every case except the rate structure used by Oregon, Illinois would experience greater revenue generation while over half of the state’s families would receive tax relief.

Using Oregon’s marginal income tax rate structure would almost double total revenue in Illinois from the individual income tax, because Oregon escalates income tax rates rapidly and for many low and middle-income earners. But given Illinois’ current deductions, credits, etc., everyone in Illinois would pay more under that rate structure. It should be noted that Oregon may have other means legislated that target tax relief directly to low and middle-income families that would offset its imposition of high income tax rates at relatively low levels of income.

**Figure 6**  
**Approximate Impact of Applying Other State**  
**Graduated Individual Income Tax Rates to Illinois**

	Revenue Increase over IL 5% Flat Tax (\$ millions)	% Revenue Increase over IL 5% Flat Tax	Tax Revenue from bottom 54.5% of Filers Compared to IL 5% Flat (\$ millions)	% Taxes Change for Bottom 54.5%	Marginal Rates (For Couple)
Current Illinois 5% Flat Rate	\$0	0.0%	\$0.0	0.0%	5%
Iowa Graduated Rates	\$6,276	42.0%	(\$358.0)	-24.7%	0.36% to 8.98%
Kentucky Graduated Rates	\$1,663	11.1%	(\$150.6)	-10.4%	2% to 6%
Missouri Graduated Rates	\$1,884	12.6%	(\$152.0)	-10.5%	1.5% to 6%
Wisconsin Graduated Rates	\$3,638	24.3%	(\$45.0)	-3.1%	4.6% to 7.75%
New York Graduated Rates	\$3,691	24.7%	(\$286.7)	-19.8%	4% to 8.97%
California Graduated Rates	\$580	3.9%	(\$1,197.8)	-82.8%	1% to 10.3%
Oregon Graduated Rates	\$14,679	98.2%	\$571.5	39.5%	5% to 11%
Hawaii Graduated Rates	\$6,858	45.9%	(\$414.8)	-28.7%	1.4% to 11%
Illinois Graduated Rate Structure Proposed in this Study	\$3,363	22.5%	(\$512.3)	-35.4%	0% to 11%

Source: CTBA approximate modeling of the impact of other state marginal individual income tax rates for a couple, when applied to detailed Illinois Department of Revenue 2007 Illinois individual income tax return data.<sup>42</sup>

However, rather than just copy a rate structure used by another state that in all likelihood has very different deductions, credits, etc. from Illinois, decision makers could design a rate structure to work in conjunction with Illinois’ current law covering such items. Figure 7 shows how such an approach could work. Given an appropriately designed graduated rate structure, Illinois could cut the overall state income tax burden for 94 percent of all taxpayers—on average providing a tax cut to every taxpayer with less than \$150,000 in base income annually, raise at least \$2.4 billion more in revenue, and keep the effective individual income tax rate for millionaires well below five percent.

**Figure 7**  
**How a Graduated Individual Income Tax Rate Could be Structured in Illinois to Cut Taxes for 94% of Filers**

Base Income	New Marginal Tax Rate	Cumulative Returns	Cumulative Returns	Taxes after deductions and credits	New Effective Tax Rate	Effective Tax Under Existing 5% Flat Tax	Tax Change from 5% Flat Tax
Less than Zero	0.00%	154,923	2.58%	-\$2,204,622	0.0%	0.0%	0.0%
\$0 > \$1,000	0.00%	180,814	5.58%	-\$814,911	-1.1%	-1.1%	0.0%
\$1,000 > \$3,000	0.00%	277,935	10.21%	-\$2,613,551	-0.5%	0.9%	-1.4%
\$3,000 > \$5,000	0.00%	260,797	14.54%	-\$5,549,492	-0.5%	2.0%	-2.6%
\$5,000 > \$7,000	5.00%	229,700	18.36%	-\$8,333,980	-0.6%	-0.6%	0.0%
\$7,000 > \$9,000	5.00%	218,885	22.00%	-\$8,754,128	-0.5%	-0.5%	0.0%
\$9,000 > \$11,000	5.00%	188,617	25.14%	\$5,274,471	0.3%	2.7%	-2.4%
\$11,000 > \$13,000	5.00%	188,003	28.27%	\$18,282,882	0.8%	2.8%	-2.0%
\$13,000 > \$15,000	5.00%	174,444	31.17%	\$32,042,829	1.3%	3.0%	-1.7%
\$15,000 > \$17,000	5.00%	166,528	33.94%	\$44,665,001	1.7%	3.2%	-1.5%
\$17,000 > \$19,000	5.00%	158,616	36.57%	\$56,858,558	2.0%	3.3%	-1.4%
\$19,000 > \$22,000	5.00%	228,452	40.37%	\$107,672,879	2.3%	3.5%	-1.2%
\$22,000 > \$25,000	5.00%	214,645	43.94%	\$130,349,148	2.6%	3.6%	-1.0%
\$25,000 > \$30,000	5.00%	334,163	49.50%	\$263,558,567	2.9%	3.8%	-0.9%
\$30,000 > \$35,000	5.00%	299,889	54.49%	\$304,437,025	3.1%	3.9%	-0.8%
\$35,000 > \$40,000	5.00%	262,617	58.85%	\$325,213,538	3.3%	4.0%	-0.7%
\$40,000 > \$50,000	5.00%	442,110	66.21%	\$687,252,030	3.5%	4.0%	-0.6%
\$50,000 > \$75,000	5.00%	776,951	79.13%	\$1,749,317,602	3.7%	4.1%	-0.4%
\$75,000 > \$100,000	5.00%	471,194	86.96%	\$1,550,055,912	3.8%	4.1%	-0.3%
\$100,000 > \$150,000	7.50%	412,809	93.83%	\$2,019,347,785	4.07%	4.15%	-0.08%
\$150,000 > \$200,000	8.50%	142,152	96.19%	\$1,149,687,723	4.7%	4.1%	0.6%
\$200,000 > \$300,000	9.50%	101,381	97.88%	\$1,298,123,782	5.3%	4.1%	1.2%
\$300,000 > \$500,000	10.00%	61,034	98.89%	\$1,380,585,183	6.0%	3.9%	2.0%
\$500,000 > \$1,000,000	10.50%	37,652	99.52%	\$1,614,565,473	6.3%	3.7%	2.6%
\$1,000,000 OR MORE	11.00%	28,999	100.00%	\$5,599,416,835	4.3%	2.1%	2.2%
<b>Total</b>		<b>6,013,310</b>		<b>\$ 18,308,436,541*</b>	<b>4.4%</b>	<b>3.5%</b>	<b>0.8%</b>
				<b>Total Tax Cut for bottom 94% of filers:</b>			<b>-\$1,061,858,505</b>

\*Note, the actual revenue raised will be approximately \$1 billion less due after adjusting for non-residents, potential tax avoidance and other factors, as discussed below in this Section.

The results shown in Figure 7 are based on Illinois implementing a graduated income tax that does not tax incomes of \$5,000 or less, keeps the tax rate at the current five percent level for taxpayers with base incomes of \$100,000 annually or less, and increases the marginal tax rate on base incomes of: (i) \$100,000 to \$150,000 to 7.5 percent; (ii) \$150,000 to \$200,000 to 8.5 percent; (iii) \$200,000 to \$300,000 to 9.5 percent; (iv) \$300,000 to \$500,000 to 10.0 percent; (v) \$500,000 to \$1,000,000 to 10.5 percent; and (vi) \$1,000,000 and above to 11.0 percent. As Figure 7 details:

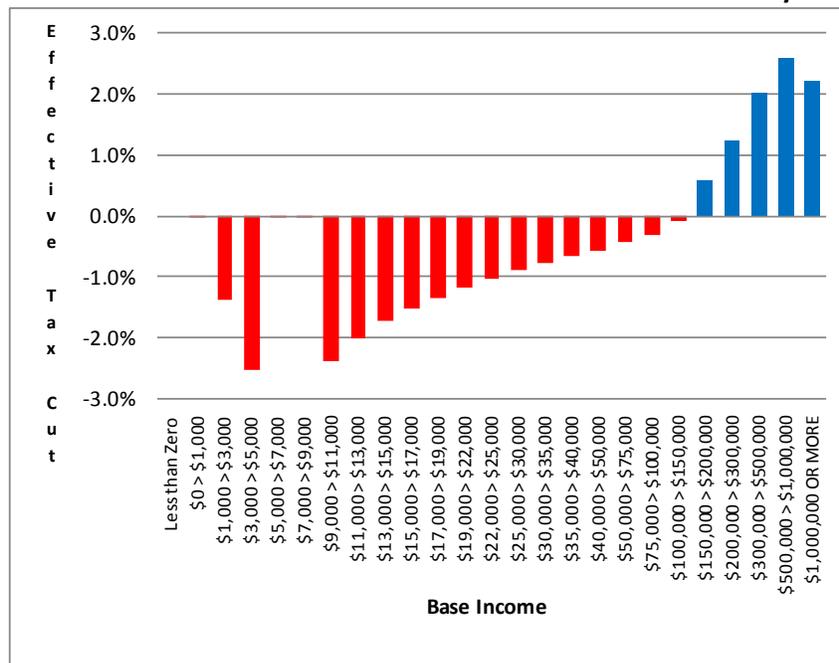
- Actual income taxes paid would be reduced to zero or below for the 22 percent of lowest-income filers (with \$9,000 or less Illinois “Base Income”<sup>43</sup> before credits and deductions), many of whom would receive an “Earned Income Tax Credit” (EITC) or property tax credit;
- Effective tax rates would be reduced on a graduated basis (the lowest income filers get the highest percentage reductions) for the next 72 percent of filers (with \$9,000 to \$150,000 in base income annually); and
- Only the top 6 percent of filers (with base incomes above \$150,000) would receive an effective tax rate increase.

In fact, the effective tax rate would increase fairly modestly for those who would pay more under this proposal, going from:

- 4.1 percent to 4.7 percent for filers with \$150,000 to \$200,000 base incomes;
- 4.1 percent to 5.3 percent for filers with \$200,000 to \$300,000 base incomes;
- 3.9 percent to 6.0 percent for filers with \$300,000 to \$500,000 incomes;
- 3.7 percent to 6.3 percent for filers with \$500,000 to \$1,000,000 incomes; and
- 2.1 percent to 4.3 percent for millionaire filers.<sup>44</sup>

The real impact on taxpayers of the proposal outlined in this paper is shown clearly in Figure 8. Note how the vast majority of taxpayers—94%— realize a reduction in income tax liability as a percentage of base income. On average, taxpayers in Illinois with less than \$150,000 in base income annually get an income tax cut. The effective tax rates go down for these households even though their marginal tax rate set by statute either remains the same (5%) as it is under current law, or increases to 7.5% for income over \$100,000, because under the graduated rate structure suggested in this study the first \$5,000 dollars of income is exempt from the income tax, which is not the case under current law. This works like an increased tax deduction of \$5,000 that can be taken by each filer (regardless of dependents and family size). And the tax relief delivered to low and middle income families would be significant. Indeed, under the proposal modeled in this study, Illinois taxpayers with the bottom 94 percent of base income collectively would receive an annual tax cut of \$1.06 billion.<sup>45</sup> As explained previously, the combined effect of this policy would be a stimulus to the economy from tax cuts and additional state spending (assuming that the additional revenue is used to fund current public services that would otherwise not be funded) that would create at least 36,000 private sector jobs in communities across Illinois.

**Figure 8**  
**Potential Effective Tax Rate Changes in Illinois with Graduated Individual Income Tax Structure Recommended in this Study**



**Figure 9**

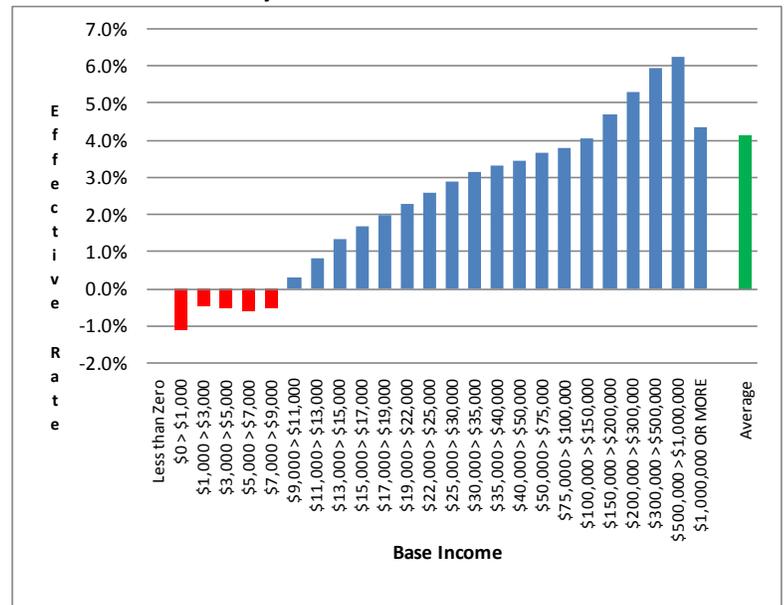
<b>Net New Revenue for the General Fund Generated by the Rate Structure Recommended in this Study (\$ millions)</b>	
Total Revenue from the Proposed Graduated Individual Income Tax Rate Structure:	\$18,308
Total Revenue from the Current 5% Flat Individual Income Tax:	\$14,946
Additional Revenue from the Proposed Graduated Individual Income Tax Rate Structure without Additional Tax Avoidance:	\$3,363
<b>Percentage Revenue Increase:</b>	<b>22.50%</b>
Potential Loss of Additional Graduated Income Tax Revenue through Increased Tax Avoidance, non-residency of filers and other factors:	(\$1,009)
Potential Net Additional Revenue from Graduate Income:	\$2,354
<b>Percentage Revenue Increase:</b>	<b>15.75%</b>

But even though more than nine out of every 10 taxpayers would realize a tax cut, the state would nonetheless raise at least \$2.4 billion or 15.8 percent more in individual income tax revenue annually than under the current five percent flat rate, as shown in Figure 9.

Note that, the potential revenue increase from the graduated rate structure outlined in this study tops out at \$3.363 billion annually. However, that top amount does not take into account either the potential increase in tax avoidance strategies frequently utilized by more affluent taxpayers in response to increases in income tax rates, nor the number of non-residents filing Illinois income tax returns. A 30% reduction in potential revenue generated due to increased tax avoidance, non-residency of filers and other factors would result in the net additional annual revenue raised declining from \$3.363 billion to \$2.354 billion.<sup>46</sup>

*Figure 10 shows that the proposal outlined in this study would create effective individual income tax rates that are far fairer than under current law—despite the fact that millionaires will still have an effective income tax rate lower than that of average filers.*

**Figure 10**  
**Effective Tax Rates by Base Income with Graduated Income Tax**



Note, the negative effective tax rate for low-income filers results from a combination of factors, including the refundability of the Illinois EITC, other deductions/credits, and not taxing any income below \$5,000.

And while Illinois would be targeting millionaires for an effective tax rate increase from 2.1 percent of income under current law to 4.3 percent under the graduated rate structure proposed in this study, there is no reasonable cause for concern that affluent families will pull up stakes and move out. In fact, according to a meta-analysis of research on this very concern published on August 4, 2011, by the Center on Budget and Policy Priorities, “compelling evidence” shows that “effects of tax increases on migration are at most, small—so small that states that raise income taxes on the most affluent households can be assured of a substantial net gain in revenue.”<sup>47</sup> That study demonstrated that the key factors in population migration include items such as housing costs, family considerations, weather, employment opportunities and age, not tax increases.<sup>48</sup>

If the goal is to raise adequate and sustainable revenue for funding public services while maintaining low overall effective tax rates, then tax burden should be assessed primarily where income levels are high and expanding most generously over time. Since 1979, the bottom 60 percent of Illinois tax filers have seen their overall incomes decline, with the vast majority of income gains going to the top 10 percent of Illinois tax filers. A graduated individual income tax rate structure would shift tax burden from families struggling to get by to those who are gaining significant growth in real income over time, generate revenue needed to help reduce the structural deficit, and stimulate job growth in the private sector from both the enhanced consumer spending that would result from the tax relief given to low and middle income families and direct expenditures by the state on core public services and infrastructure.

## APPENDIX

**Figure 1A: Illinois Individual Income Tax by Base Income Under 5% Flat Tax**

Base Income <sup>43</sup>	Marginal Tax rate	Returns	Cummulative Returns	Taxes after deductions and credits <sup>38</sup>	Average Taxes	Share of Total Revenue	Cummulative Share of Total Revenue	Effective Tax Rates
Less than Zero	0.00%	154,923	2.58%	-\$2,226,553	-\$14	-0.01%	-0.01%	0.0%
\$0 > \$1,000	5.00%	180,814	5.58%	-\$823,017	-\$5	-0.01%	-0.02%	-1.1%
\$1,000 > \$3,000	5.00%	277,935	10.21%	\$5,098,120	\$18	0.03%	0.01%	0.9%
\$3,000 > \$5,000	5.00%	260,797	14.54%	\$20,924,492	\$80	0.14%	0.15%	2.0%
\$5,000 > \$7,000	5.00%	229,700	18.36%	-\$8,416,886	-\$37	-0.06%	0.10%	-0.6%
\$7,000 > \$9,000	5.00%	218,885	22.00%	-\$8,841,214	-\$40	-0.06%	0.04%	-0.5%
\$9,000 > \$11,000	5.00%	188,617	25.14%	\$50,584,553	\$268	0.34%	0.38%	2.7%
\$11,000 > \$13,000	5.00%	188,003	28.27%	\$63,575,046	\$338	0.43%	0.80%	2.8%
\$13,000 > \$15,000	5.00%	174,444	31.17%	\$74,218,469	\$425	0.50%	1.30%	3.0%
\$15,000 > \$17,000	5.00%	166,528	33.94%	\$85,066,806	\$511	0.57%	1.87%	3.2%
\$17,000 > \$19,000	5.00%	158,616	36.57%	\$95,483,223	\$602	0.64%	2.51%	3.3%
\$19,000 > \$22,000	5.00%	228,452	40.37%	\$163,559,808	\$716	1.09%	3.60%	3.5%
\$22,000 > \$25,000	5.00%	214,645	43.94%	\$183,148,746	\$853	1.23%	4.83%	3.6%
\$25,000 > \$30,000	5.00%	334,163	49.50%	\$346,361,018	\$1,037	2.32%	7.14%	3.8%
\$30,000 > \$35,000	5.00%	299,889	54.49%	\$379,422,277	\$1,265	2.54%	9.68%	3.9%
\$35,000 > \$40,000	5.00%	262,617	58.85%	\$391,462,263	\$1,491	2.62%	12.30%	4.0%
\$40,000 > \$50,000	5.00%	442,110	66.21%	\$800,170,668	\$1,810	5.35%	17.66%	4.0%
\$50,000 > \$75,000	5.00%	776,951	79.13%	\$1,953,144,911	\$2,514	13.07%	30.72%	4.1%
\$75,000 > \$100,000	5.00%	471,194	86.96%	\$1,678,536,258	\$3,562	11.23%	41.95%	4.1%
\$100,000 > \$150,000	5.00%	412,809	93.83%	\$2,057,467,062	\$4,984	13.77%	55.72%	4.15%
\$150,000 > \$200,000	5.00%	142,152	96.19%	\$1,008,545,711	\$7,095	6.75%	62.47%	4.14%
\$200,000 > \$300,000	5.00%	101,381	97.88%	\$995,113,100	\$9,816	6.66%	69.13%	4.1%
\$300,000 > \$500,000	5.00%	61,034	98.89%	\$913,018,467	\$14,959	6.11%	75.24%	3.9%
\$500,000 > \$1,000,000	5.00%	37,652	99.52%	\$944,701,692	\$25,090	6.32%	81.56%	3.7%
\$1,000,000 OR MORE	5.00%	28,999	100.00%	\$2,756,376,072	\$95,051	18.44%	100.00%	2.1%
Total		6,013,310		\$14,945,671,093	\$2,485	100.00%		3.4%
Total Revenue from 5% Flat Individual Income Tax:				\$14,945,671,093				
Additional Revenue:				\$0				
% Additional Revenue:				0.00%				
Source: CTBA calculations from Illinois Department of Revenue 2007 Individual Income Tax data by detailed Base income brackets and 2009 data by detailed Net income brackets. <sup>38</sup>								

## ENDNOTES

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- <sup>1</sup>Institute on Taxation and Economic Policy (ITEP). "Who Pays? A Distributional Analysis of the Tax Systems in All 50 States, 3<sup>rd</sup> Edition." November 2009.
- <sup>2</sup>Illinois General Assembly: P.A. 97-0652
- <sup>3</sup>Illinois Economic Review, May 2011, Institute of Government and Public Affairs.
- <sup>4</sup>International Monetary Fund (IMF). "World Economic Outlook: Showing Growth, Rising Risks" September 2011.
- <sup>5</sup>T.Piketty and E. Saez. "Income Inequality in the United States 1913-2002. November 2004.
- <sup>6</sup>Op. Cit. IMF "World Economic Outlook: Showing Growth, Rising Risks."
- <sup>7</sup>Senator Bob Casey. "How Continuing the Payroll Tax Cut and Federal UI Benefits will Help American Families and Support the Recovery:" A Report by the U.S. Congress Joint Economic Committee. January 24, 2012.
- <sup>8</sup>Op. Cit. ITEP "Who Pays?" p. 42. The only states with a higher state and local tax burden on the Lowest 20% of families are Washington, and Florida, neither of which have a state personal income tax.
- <sup>9</sup>Illinois Constitution 1970, Article IX, Section 3(a) "A tax on or measured by income shall be at a non-graduated rate."
- <sup>10</sup>Federation of Tax Administrators. "State Personal income taxes." February, 2011.
- <sup>11</sup>The Illinois "effective" tax rate is the overall (not graduated) percentage of Illinois "base" income (see Footnote 42) that a filer pays in Illinois Individual Income Taxes after deductions and credits.
- <sup>12</sup>Senate Democratic Caucus Staff. Tax Relief for Illinois Families Signed by Governor, P.A. 97-0652, January 10, 2012.
- <sup>13</sup>Op Cit. Page 42.
- <sup>14</sup>Op. Cit. ITEP "Who Pays?"
- <sup>15</sup>Adam Smith. Wealth of Nations. Book 5, Chap. 2, Part 2. W. Strahan and T. Cadell, London, 1776.
- <sup>16</sup>Op. Cit. Book 5, Chap. 2, Article I, footnote 4.
- <sup>17</sup>Op. Cit. Book 2, Article 1 (V. 2. 71).
- <sup>18</sup>Center for Tax and Budget Accountability analysis of Current Population Survey data. Inflation based on Bureau of Labor Statistics, CPI-U-RS.
- <sup>19</sup>There was an average 6.4% decline in real family income from 1973 to 2008 for the bottom 90% of families in spite of overall real family income growth of 20.6% over the period. Calculations from data provided by Emmanuel Saez, Department of Economics, University of California, Berkeley at: <http://www.econ.berkeley.edu/~saez/TabFig2008.xls>, Tables A0 and A6.
- <sup>20</sup>Federal Income Tax of 1913, Major Acts of Congress. Ed. Brian K. Landsberg. MacMillen-Thomson Gale, 2004.
- <sup>21</sup>A Blueprint for New Beginnings: A Responsible Budget for America's Priorities, Pg. 34 (2001).
- <sup>22</sup>Id. Pg. 34
- <sup>23</sup>Op. Cit. ITEP "Who Pays?"
- <sup>24</sup>Hugh Stretton. Economics: A New Introduction. p. 623. Pluto Press, London, 1999.
- <sup>25</sup>Illinois Constitution Article IX, Section 3(a).
- <sup>26</sup>Of the 41 states with a comprehensive income tax, only seven including Illinois have a flat rate. Among our neighbors only Indiana has a flat income tax rate, see Federation of Tax Administrators, Feb. 2011 "State Individual Income Taxes".
- <sup>27</sup>CTBA Structural Adjustment Model updated as of Nov. 2011, uses data from the Commission on Government Forecasting and Accountability (COGFA), Governor's Office of Management and the Budget (GOMB) and the U.S. Bureau of Labor Statistics (BLS). Detailed assumptions and calculations available upon request.
- <sup>28</sup>United States Department of Commerce.
- <sup>29</sup>Center on Budget and Policy Priorities, "Relieving the Recession: Nineteen Ways States can Assist Low-Income Families During the Downturn."
- <sup>30</sup>J. Bradford DeLong – "The Size of the Multiplier and the Marginal Propensity to Consume," March 1998, UC Berkeley, Department of Economics. [http://econ161.berkeley.edu/multimedia/Size\\_Multiplier.html](http://econ161.berkeley.edu/multimedia/Size_Multiplier.html).
- <sup>31</sup>Joseph Stiglitz – "Letter to Governor David A. Paterson," March 2008, Columbia University Business School.
- <sup>32</sup>Institute on Taxation and Economic Policy, "High Rate" Income Tax States are Outperforming No-Tax States, February 2012
- <sup>33</sup>United States Bureau of Labor Statistics.State and Area Employment Division. Illinois employment data, seasonally adjusted, 2000-2010. Data retrieved 10-26-2010.
- <sup>34</sup>The number of jobs estimate is dependent on how much additional tax revenue is raised which depends on the extent to which individuals will engage in additional tax avoidance under graduated income taxes. This increased tax avoidance could reduce additional revenue from a graduated income tax by up to 30% - see Figure 9 in text of this Report.
- <sup>35</sup>Joseph Stiglitz – "Letter to Governor David A. Paterson," March 2008, Columbia University Business School; Lawrence Mishel & Heidi Shierholz – "Without Adequate Public Spending, A Catastrophic Recession for Some," January 2009, Economic Policy Institute, [www.epi.org](http://www.epi.org); Faiz Shakir et al – "Right Wing Myths About The Stimulus," January 2009, The Progress Report, [www.thinkprogress.org](http://www.thinkprogress.org); Nicholas Johnson – "Budget Cuts or Tax Increases at the State Level: Which is preferable during a recession?" January 2009, Center on Budget and Policy Priorities, [www.cbpp.org](http://www.cbpp.org); Josephine B. Valle – "The Multiplier Effect Explained," December 2008, Business World Research, [www.bworldonline.com](http://www.bworldonline.com).
- <sup>36</sup>PA 96-1496 signed into law June 30 2011, raised the Illinois Personal Income Tax rate from 3% to 5% and the Corporate Income Tax rate from 4.8% to 7% for 2011 to 2014. These rates are supposed to go back down in subsequent years, eventually to 3.25% and 4.8%, respectively in 2025.
- <sup>37</sup>Though CTBA supported the tax increase as absolutely necessary to avoid a complete state fiscal collapse, we urged that a tax credit for low-income families be included, that the state sales tax base be expanded to include services, and that high-income retirees be taxed. These measures would have made the tax increase more progressive and raised additional revenue to fund public services and pay back bills – see "Funding Our

Future,” Oct. 2010 at: [http://www.ctbaonline.org/New\\_Folder/Budget,%20Tax%20and%20Revenue/FINAL%20Funding%20Our%20Future-CTBA%20Report%2010.29.2010.pdf](http://www.ctbaonline.org/New_Folder/Budget,%20Tax%20and%20Revenue/FINAL%20Funding%20Our%20Future-CTBA%20Report%2010.29.2010.pdf).

<sup>38</sup> Our modeling is based on 2007 data (the most recent Illinois tax data by detailed *base* income brackets that we were able to obtain from the Illinois Department of Revenue). However, these results are calibrated to equal estimates based on 2009 tax data by *net* income bracket that were provided to CTBA by the Illinois Department of Revenue (IDOR) on Feb. 6, 2012. These 2009 data are adjusted by the application of a 5% tax rate (instead of the original 3%) and by an adjustment for inflation from 2009 to 2012 (CPI growth of 9.43%). IDOR has suggested that this provides the most accurate base for estimating the impact of changed tax rates. CTBA therefore employed IDOR’s suggested methodology because estimates based on *net* income brackets will be more accurate for projecting revenue changes. Graduated tax incidence for each net income bracket is calculated by multiplying the number of returns times the bracket net income increment times the graduated tax rate for this increment for all lower tax brackets, and the residual of this times the top tax rate. For example, IDOR 2009 net Individual Income Tax data shows total net income of \$45,435,659,599 (after adjusting for 9.43% 2009 to 2012 CPI increase and additional \$50 increase in based exemption enacted in December 2011) for 120,608 filers with net income between \$100,000 and \$150,000. Graduated Individual Income Tax for these filers using the rates in Figure 7, will therefore equal  $120,608 \times (\$5,000 \times 0\% + \$95,000 \times 5\%) + (\$45,435,659,599 - 120,608 \times \$100,000) \times 7.5\%$ . Total tax credits for this net income bracket (adjusted for 2009-12 inflation and additional Dec. 2011 EITC credit) are then deducted from this to get final estimated 2012 “Taxes paid after deductions and credits” for this net income bracket. However, net income brackets do not allow for estimation of effective tax rates by *base* income. Taxes by base income bracket are estimated in the same way with deductions taken off of the “top” of the bracket. As noted, these estimates by base income bracket are then “calibrated” to aggregate tax revenue from the net income calculation. As it turns out, the aggregate difference for additional revenue generated from moving to a graduated rate structure between using net and base income as the starting point is less than 1% (\$33.5 million). CTBA also accounted for changes to the Illinois personal income tax enacted in December 2011, that increased the 2012 standard exemption to \$2,050 from \$2,000—resulting in an estimated \$31 million 2012 Individual Income Tax revenue loss, and that increased the Illinois EITC to 7.5% (from 5%) of the federal EITC resulting in an estimated \$52 million 2012 Individual Income Tax revenue loss.

<sup>39</sup> Note that these calculations isolate the *Illinois* only effective state income tax rates. High base income non-resident filers have a disproportionate impact on Illinois effective rates. Non-residents are required to pay Illinois state income tax only on income sourced directly from Illinois. A proportion of non-residents may be paying state income tax to other states which would raise their cumulative effective state income tax rate paid to all states, but that does not illustrate the differential between states. Another portion may claim residency in one of the seven states (as of 2011) including Florida with *no* state income tax so that any of their income that is not directly sourced from a state with income taxes will not be taxed at the state level. CTBA has not been able to obtain more detailed data on the respective importance of these proportions.

<sup>40</sup> Note again these effective rates are *Illinois* effective rates per discussion in the footnote above.

<sup>41</sup> This estimate uses the model discussed in footnote 38 above, with approximate Iowa tax rates (see footnote 42 below). Detailed assumptions and calculations used for Iowa and other state individual income tax rates applied to Illinois taxpayers available upon request.

<sup>42</sup> These estimates use 2007 IDOR data on Individual Income Tax revenue by detailed *base* income bracket (see footnote 41). Because the estimates are based on tabular, rather than individual, data, marginal tax rates for deductions have to be approximated by using the highest marginal rate based on the Illinois “Base Income” of filers in this Base Income bracket. However, as noted in footnote 38, these estimates have been calibrated to equal estimates by *net* income brackets that will be accurate and the overall difference in estimates is very small (less than 1%). Further approximation is necessary when applying marginal Individual Income Tax rates from other states with income brackets that cannot be precisely replicated using the 2007 IDOR detailed income brackets. In these cases only the closest approximate brackets can be used so that these estimates approximate but are not completely accurate applications of other state rates to Illinois data. However, as the approximate brackets are generally fairly close to the statutory brackets, these estimates should be fairly accurate. Finally, as is noted in the text, CTBA uses only the *marginal tax rates* from other states to which we apply Illinois deductions (per the approximation discussed above) and credits for these estimates.

<sup>43</sup> Illinois “Base Income” is federal Adjusted Gross Income (AGI) with some modifications, the most important of which are the addition of federal (but not Illinois) tax exempt interest and dividend income and the subtraction of social security and other retirement income not taxed in Illinois. See 2010 Form IL-1040, Illinois Department of Revenue for further details.

<sup>44</sup> The Effective Rate drops for millionaire filers because they are able to avoid paying state taxes on such a high share (55.3%) of their base income, more than four times the deduction share of middle income filers. Other millionaire filers are “non-residents” who pay no Illinois taxes on income not directly sourced from Illinois – see footnote 3 above. For example a filer who purchases a condo in Florida and claims Florida residency does not have to pay any Illinois (or Florida) state income tax on non-Illinois sourced earnings as Florida has no state income tax. The marginal tax rate on million dollar or higher incomes would have to be set above 20% to raise the Effective Rate for millionaire filers above the 6.3% Effective Rate for filers in the \$500,000 to \$1,000,000 base income bracket. However, as the top marginal state tax rate (in Oregon and Hawaii) is currently 11%, CTBA developed a graduated income tax rate proposal for Illinois with a top marginal rate no higher than 11%.

<sup>45</sup> Under a 5% flat tax the bottom 94% of filers pay \$8.33 billion in taxes. With the graduated rate structure proposed in this study they pay \$7.27 billion, because the first \$5,000 of their income is not taxed. The difference is \$1.1 billion.

<sup>46</sup> This estimate is from an Illinois Department of Revenue “dynamic” model that takes non-residency and potential additional tax avoidance by individual tax payers into account.

<sup>47</sup> “Tax Flight is a Myth, Higher State Taxes Bring More Revenue, Not More Migration,” Center on Budget Policy and Priorities, August 4, 2011.

<sup>48</sup> *Id.*