CTBA | Center for Tax and Budget Accountability

October 16, 2020

Graduated Rate Income Tax
Frequently Asked Questions (FAQ)

On November 3, 2020, Illinois voters will have the chance to ratify the proposed amendment to the Illinois Constitution that would allow for a graduated rate income tax structure.[1] The graduated income tax rates put forth by state decision-makers is often referred to as the "**Fair Tax**" by proponents. This is because the structure, which taxes lower incomes at lower rates and higher incomes at higher rates, is deemed more fair and able to respond to how wealth and income grow in the modern economy.

Over the past several months, the Center for Tax and Budget Accountability ("**CTBA**") has been compiling some of the most frequently asked questions about the Fair Tax and has created this FAQ Fact Sheet to help voters understand this ballot initiative.

Frequently Asked Questions

1. What is Illinois' current tax structure?

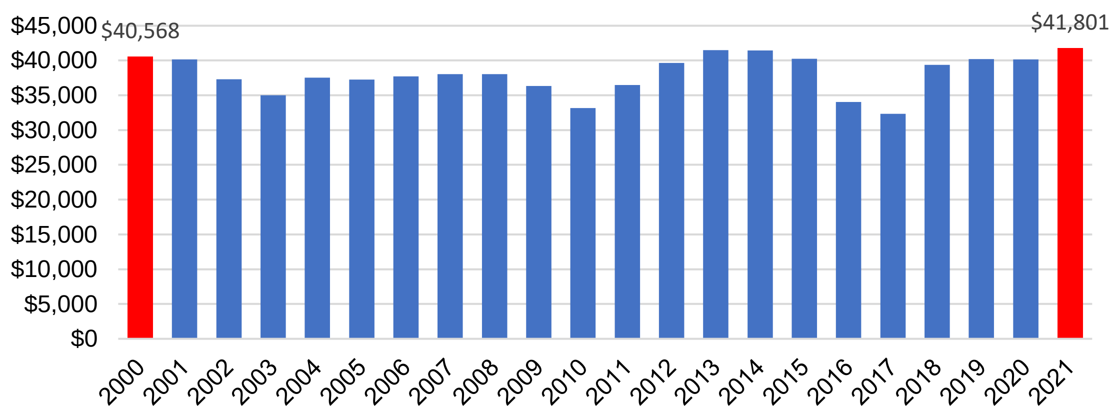
Currently, the Illinois Constitution allows for a flat income tax structure which imposes a rate of 4.95%. This means every taxpayer, regardless of their overall income level and ability to pay, will pay 4.95% of his/her/their taxable income in taxes. The Illinois Constitution specifically prohibits a graduated rate structure, which is why there is an amendment on the ballot in November.

For more information, please read [Implementing the "Fair Tax" Will Help the Illinois Fiscal System.]()

2. Why does Illinois need a new tax structure?

Illinois needs a new tax structure that will raise enough revenue to provide for the **same level of spending on services year-over-year**. This year, in FY 2021, total General Fund revenue was initially projected to be roughly equivalent to what it was in FY 2000, **which means there has been no real revenue growth in the state's General Fund for over two decades,** as seen in **Figure 1**. If there is no real growth in revenue, then the state cannot keep up with the natural increase in the cost of providing services to residents.

Figure 1
Total General Fund Revenue, FY 2000 – FY 2021 ($ millions)
Inflation-adjusted Using 2020 Dollars—Without Adjusting for the Impact of COVID-19



Source: CTBA Report, "Analysis of Illinois' FY 2021 Enacted General Fund Budget", 2020.[2]

For more information, please read [Illinois FY 2021 Enacted General Fund Budget Analysis.]()

3. How does Illinois spend (income) tax revenue?

Illinois' General Fund Budget appropriates funding to two categories of spending: "**Hard Costs**" and "**Current Services.**"

Hard Costs are mandatory spending obligations over which there is no discretion because they are required to be paid either by existing laws or contractual obligations, such as:

- debt service payments owed to bondholders; and/or
- health insurance benefit payments for state workers.

Current Services cover spending on public services over which elected officials have some discretion, such as:

- education;
- healthcare;
- human services; and
- and public safety.

Over 95 percent of all General Fund spending on Current Services goes to the four core service areas of education, healthcare, human services, and public safety. Contrary to rhetoric that Illinois has a spending problem, **Illinois is spending less on core services than it did in FY 2000**. As seen in **Figure 2**, in FY 2021, total General Fund spending on services is scheduled to be $7.26 billion, or 20.53 percent less in real, inflation-adjusted dollars than it was twenty years ago in FY 2000 under Republican Governor George Ryan.

Figure 2
Illinois General Fund Appropriations for Core Services, FY 2000 Compared to FY 2021

Category	FY 2000 Enacted (Nominal)	FY 2000 Enacted (inf. adj.)	FY 2021 Enacted	$ Change (inf. adj.)	% Change (inf. adj.)
Healthcare	$5,022	$10,000	$8,171	($1,829)	-18.29%
Human Services	$4,599	$8,105	$6,915	($1,190)	-14.68%
K-12 Education	$4,674	$8,238	$8,352	$115	1.39%
Higher Education	$2,152	$3,793	$1,943	($1,850)	-48.77%
Early Childhood Education	$170	$300	$544	$244	81.48%
Public Safety	$1,350	$2,219	$1,909	($471)	-19.78%
Total Net General Fund Service Appropriations	**$20,064**	**$35,362**	**$28,101**	**($7,260)**	**-20.53%**

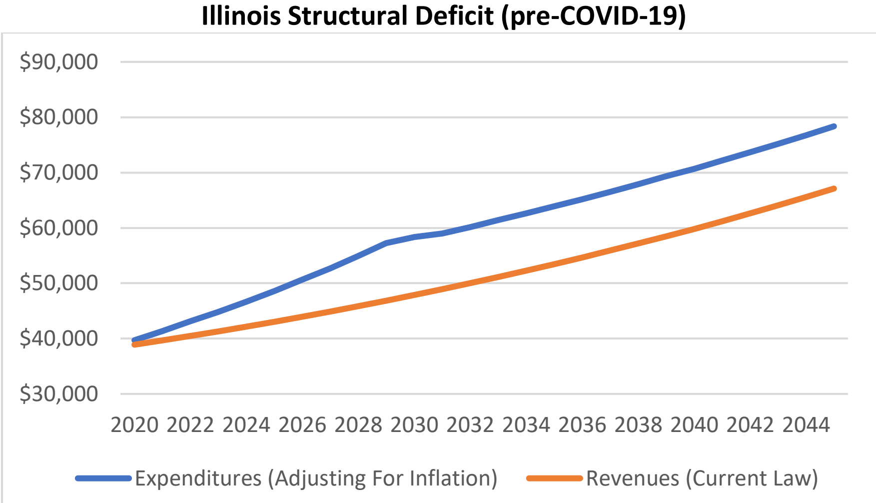
Source: CTBA Report, "Analysis of Illinois' FY 2021 Enacted General Fund Budget", 2020.

For more information, please read [Illinois FY 2021 Enacted General Fund Budget Analysis.]

4. What is the "structural deficit"?

Even when services are not added or increased, and even when the economy is growing normally, the rate of growth in the tax revenue feeding the state's General Fund is not sufficient to continue supporting the same level of public services from one fiscal year into the next. This is called a "**structural deficit,**" and it has continuously plagued the state's General Fund for generations. The projection of how the structural deficit in the state's General Fund would have grown in future years is shown in **Figure 3**—before accounting for what will certainly be significant revenue losses generated by the COVID-19 pandemic.

Figure 3
Illinois Structural Deficit (pre-COVID-19)



Source: CTBA, "Analysis of FY 2021 Enacted General Fund Budget," 2020.

For more information, please read [Illinois FY 2021 Enacted General Fund Budget Analysis.]

5. How does the pension system fit in?

The FY 2021 Enacted General Fund Budget includes a $9.03 billion appropriation for pensions, which is the required General Fund contribution for FY 2021 as identified by the 1995 Pension Ramp.

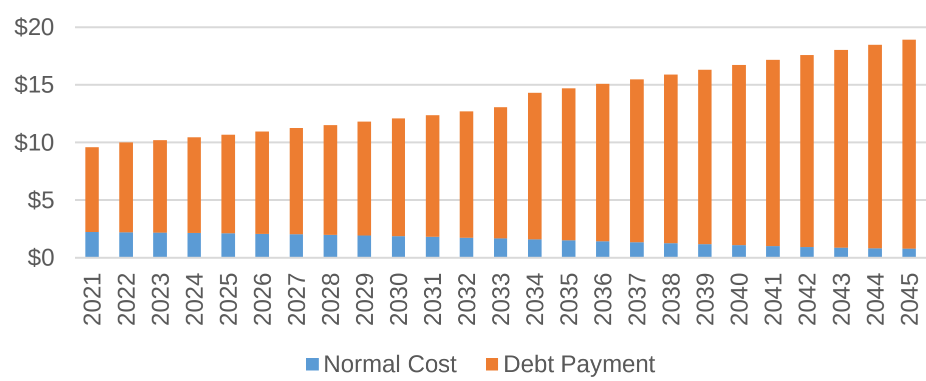
The Pension Ramp established by law in 1995 increases the state's contribution to its five pension systems each year until they are fully funded. The Pension Ramp got its name precisely because it provided for the repayment of the pension debt by substantially "ramping-up" the annual repayments over the FY 2011-2045 sequence. **However**, **it established a pension debt repayment schedule that was so unrealistically backloaded it is unaffordable.**

That is because, for the first 15 years of the Pension Ramp, the state deliberately underfunded the contributions to the pension systems. Hence by law, the Pension Ramp simply continued the prior practice of intentionally underfunding public pensions and diverting what should have gone to cover the required contributions to instead pay for current service delivery. Effectively, this meant the state was borrowing from the pensions to pay for services.

Essentially, leaders in both parties lacked the political will to raise taxes to eliminate the structural deficit and support current service expenditures with current revenue. So, they chose instead to borrow against what was owed to the pension systems to cover a portion of the structural deficit and leave the obligation to repay the pension systems to future generations.

Figure 4 shows the current Pension Ramp.

Figure 4
Projected All Funds Contributions to State Pension Systems ($ Billions)



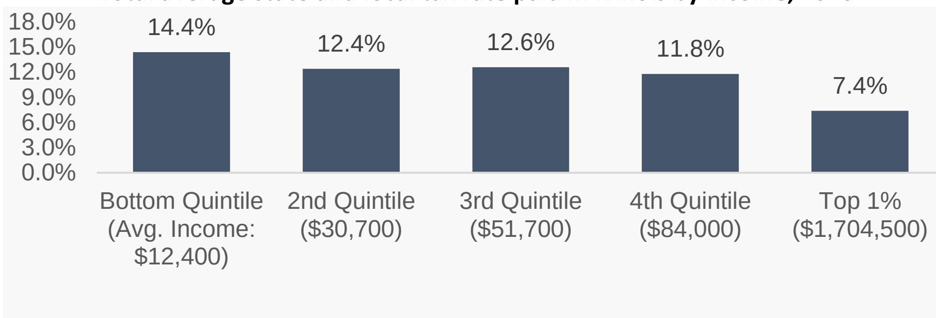
Source: CTBA, "Analysis of FY 2021 Enacted General Fund Budget," 2020.

For more information, please read [Impact on Illinois' Structural Deficit.](#)

6. If everyone is paying the same rate, why isn't that enough?

Illinois' overall tax system is regressive, meaning that it imposes a much higher tax burden on low- and middle-income families than it does on wealthy families. Illinois currently has the **eighth** most regressive tax structure of any state in the nation. The poorest 20 percent of families in Illinois pay 14.4 percent of their income in state and local taxes, while the top one percent of families pay just 7.4 percent, as shown in **Figure 5**.

Figure 5
Total average state and local tax rate paid in Illinois by income, 2016



Source: ITEP, "Who Pays?" 6th edition, 2018

The only tax that can help offset the regressivity and provide the necessary revenue is the income tax.

For more information, please read Implementing the "Fair Tax" Will Help the Illinois Fiscal System.

7. What is the Fair Tax?

The Fair Tax is a graduated rate income tax structure which taxes lower levels of income at lower rates and higher levels of income at higher rates. Specifically, the Fair Tax is made up of six brackets, as seen in **Figure 6,** that range from a 4.75% to a 7.99%. Typical of a graduated income tax structure, the marginal rate is the rate at which income within a bracket is taxed.

Figure 6
Illinois Proposed Graduated Rate Income Tax Structure

Marginal Rate	Income Bracket (Single)	Income Bracket (Joint)	Percent of Taxpayers
4.75%	$0-$10,000	$0-$10,000	27.2%
4.90%	$10,001 - $100,000	$10,001-$100,000	58.9%
4.95%	$100,001 - $250,000	$100,001-$250,000	11.1%
7.75%	$250,001 - $350,000	$250,001-$500,000	1.9%
7.85%	$350,000- $750,000	$500,001-$1,000,000	0.6%
7.99%	$750,001 and over	$1,000,001 and over	0.3%

Source: CTBA analysis of P.A. 101-0008 and 2017 IDOR IIT stratification data (received via FOIA request)

Income over $750,000 ($1M jointly), will be taxed at a flat rate of 7.99% on total taxable income and is not subject to the marginal tax rates.

For more information, please read Implementing the "Fair Tax" Will Help the Illinois Fiscal System.

8. How does the Fair Tax work?

The Fair Tax breaks a person's income into different brackets which are taxed at different marginal rates.

For example, if an individual filing a single return had taxable income of $120,000, she would pay $5,940 in taxes under the current flat tax rate of 4.95 percent.

Under the Fair Tax structure, that same taxpayer with $120,000 of taxable income would pay $5,875. This is because under the Fair Tax structure, the first $10,000 of taxable income would be taxed at the rate of 4.75 percent. Her next $90,000 of taxable income would be taxed at a 4.9 percent rate. Her remaining $20,000 of taxable income would be taxed at a rate of 4.95 percent. The effective income tax rate for this taxpayer—the share of income paid in taxes—would be 4.89 percent, which is the $5,875 in income taxes she paid, divided by her $120,000 of total taxable income, as shown below in **Figure 7**.

Figure 7
How $120K in Total Taxable Income Would Be Taxed Under the Fair Tax (Single Filer)

Bracket Number	Income Bracket (Single)	Marginal Rate	Income Bracket (Single)	Taxes for Income Bracket
1.	$0-$10,000	4.75%	$10,000	$475
2.	$10,001 - $100,000	4.90%	$90,000	$4410
3.	$100,001 - $250,000	4.95%	$20,000	$990
	Effective Tax Rate:	4.90%	$120,000	$5,875

Source: CTBA analysis of P.A. 101-0008 and 2017 IDOR IIT stratification data (received via FOIA request)

For more information, please read Implementing the "Fair Tax" Will Help the Illinois Fiscal System.

9. How much of a tax cut will 97% of taxpayers receive?

Depending on the level of taxable income, individuals could see a reduction in tax liability up to $65.[3]

For more information, please read Implementing the "Fair Tax" Will Help the Illinois Fiscal System.

10. How much revenue will be generated from the Fair Tax?

Initial estimates projected $1.4 billion in revenue for FY 2021 (January 1 to June 30, 2021). However, due to the economic recession as a result of the COVID-19 pandemic, FY 2021 estimates were reduced to $1.3 billion. At this time, it is not certain what the long-term impact of COVID-19 will be on revenue estimates.

For more information, please read Implementing the "Fair Tax" Will Help the Illinois Fiscal System.

11. How will the revenue generated from the Fair Tax be used?

Revenue generated by the Fair Tax is likely to cover spending on core services. Governor Pritzker's Proposed Budget for FY 2021 had allocated Fair Tax revenue towards spending on capital projects, education, local governments, public safety, and human services.[4] It is also likely that the new revenue could go towards hard costs. Similarly, in the FY 2020 Proposed Budget, Governor Pritzker aimed to use $200 million in Fair Tax revenue towards pension debt in addition to the required contribution the state is obligated to make.[5]

12. Will the Fair Tax hurt the Illinois economy or jobs?

Simply put, no. One of the largest growth factors for the economy is consumer spending, which makes up about two-thirds of economic growth each year. When consumer spending increases, jobs are created, and the economy expands. On the flip side, when consumer spending declines, jobs are lost, and the economy shrinks.

The Fair Tax is anticipated to increase consumer spending in two ways because:

1. The tax relief provided to the 97% of taxpayers will likely be spent within the taxpayers' local economies; and
2. Increased spending on current services would likely maintain/create public sector jobs. The income from the public sector jobs would then be spent in the local economy as consumer spending.

When the state cuts spending on services, people lose jobs and their spending decreases, which in turn hurts the economy. **Not only will the revenue from the Fair Tax prevent cuts in service spending, but the additional tax relief could result in additional consumer spending, resulting in growth of both jobs and the state's economy.**

For more information, please read Implementing the "Fair Tax" Will Help the Illinois Fiscal System.

13. What about Connecticut?

Connecticut has updated and amended their income tax structure eight times in the last 25 years, but the revenue is not enough to keep up with the loss of jobs and industry. Since the fall of the Berlin Wall in 1989, Connecticut has seen slow economic growth due to the decrease in national defense manufacturing contracts, a financial recession in the early 1990s, and a hurricane in 1992 that caused Connecticut to restructure its insurance industry, one of the largest industries for the state.[6] Connecticut's graduated rate income tax structure is trying to address income inequality and slow employment growth in the state, not exacerbate it.

14. Will the Fair Tax cause people to leave the state?

No. Evidence shows that even after taxes are increased, people generally do not leave their home states due to family ties. Other top reasons cited include a sense of belonging, connection to friends, and having a good place to raise children. The people with the highest migration rates are usually those with lower levels of income who are migrating as an attempt to better their lives or those with a master's degree or higher between the ages of 18-29.

Furthermore, **many studies have shown that a vast majority of individuals are drawn to states that have strong public services, which are paid for by tax dollars.** One study in particular found that, "amenities such as cultural facilities, recreational opportunities and well managed public services" [7] attract potential new residents. Well-funded public education matters as well. This suggests that simply having a graduated rate income tax with higher rates on higher levels of income and lower rates with lower levels of income will not drive migration out of a state.

For more information, please read Debunking the Myth that Tax Policy Causes Out-Migration.

15. Will this give the General Assembly the authority to increase tax rates in the future or tax retirement income?

Not at all. The Fair Tax does not provide any new legal or constitutional authority that does not already exist today. Tax rates are currently set by legislators and can be increased or decreased without input from taxpayers. This is the same for retirement income. However, retirement income is also *not i*ncluded in the Fair Tax amendment, and legislators have explicitly stated that they are *not* in favor of taxing retirement income in Illinois.[8]

Even more, research shows that states with a graduated rate income tax structure were more than twice as likely to reduce taxes, particularly on the middle class, than to increase them.

For more information, please read States with Graduated Income Taxes Are More Than Twice as Likely to Cut Taxes.

16. What is the "Marriage Penalty"?

Under the Fair Tax legislation, two taxpayers with combined income and filing jointly could see slightly less in tax relief than two taxpayers with similar income filing separately (single). For joint filers with taxable incomes that are greater than $10,000 but less than $100,000 per year, the average marriage penalty is only $14.25 in lesser tax relief.[9] Similarly, joint filers with taxable incomes over $100,000 but less than $250,000 per year, the average marriage penalty would be $48.50 in lesser tax relief than similarly situated single filers.[10]

Even with the existence of this very insignificant marriage penalty that would pertain under the Fair Tax, **97 percent of joint filers would nonetheless still pay less in income taxes under the Fair Tax than they do under the current flat tax structure**.

17. If this isn't a 'silver bullet', why bother?

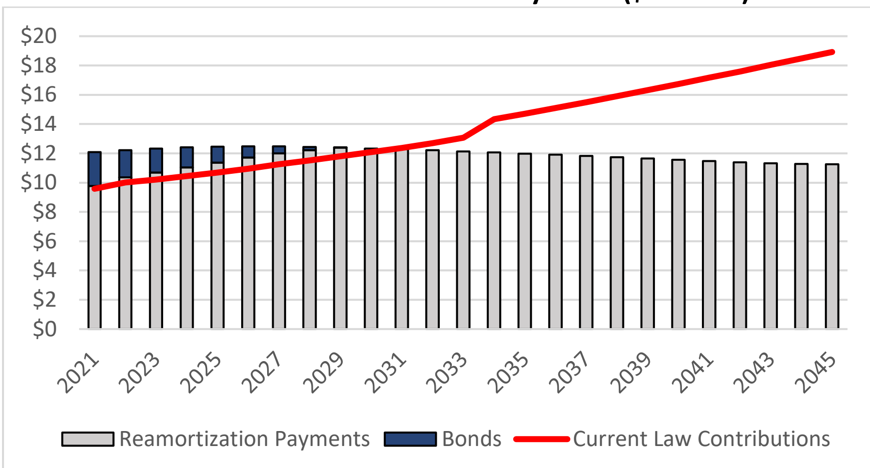
Because changing to a graduated rate income tax structure is good tax policy, which allows Illinois revenue to respond to the modern economy and levy taxes where growth is seen in the economy.

For more information, please read Implementing the "Fair Tax" Will Help the Illinois Fiscal System.

18. What else could be done to promote fiscal responsibility for Illinois?

In addition to implementing the Fair Tax, Illinois can re-amortize the Pension Ramp. CTBA identified a level-dollar re-amortization scenario that would cost $45 billion less in taxpayer dollars than the Pension Ramp through FY 2045, as shown in **Figure 8**.

Figure 8
CTBA Pension Re-amortization and Current Law All Funds Contributions to State Pension Systems ($ Billions)



Source: CTBA, "Analysis of FY 2021 Enacted General Fund Budget"

Another way Illinois could limit fiscal burden is sales tax modernization. Sales tax modernization would not only tax goods but expand taxations to services. This would be beneficial for Illinois because currently, Illinois has one of the narrowest sales tax bases of any state.

For more information, please read [Impact on Illinois' Structural Deficit.](#)

19. What if the Fair Tax doesn't pass?

The Illinois Lieutenant Governor, Julia Stratton, made a statement at the end of September 2020 saying that if the Fair Tax does not pass, there are two options available for Illinois.[11] The first is cutting service spending by 15%. However, that 15 cut could be detrimental to all Illinois residents and would slow down the economic recovery from the COVID-induced recession, especially considering Illinois is already spending less on social services in FY 2021 than it was in FY 2000, after adjusting for inflation.

The only other option available to the state would be to increase the tax rate by 20%—an increase from the current 4.95% to 5.94%—for all 6.2 million Illinois taxpayers instead of the 189,000 who make up the top 3% of Illinois taxpayers.[12] This increase in the tax rate from 4.95% to 5.94% would be particularly harmful to low- and middle-income households. For example, if the tax rate increases to 5.94%, a person earning $15 an hour could see his/her income tax liability increase by nearly $300.

20. What will I be voting on in November?

In November, you will be voting on a Constitutional Amendment removing language that prohibits the state from implementing a graduated rate structure. The Fair Tax rate structure has already been passed by the General Assembly and been signed into law by the Governor. However, the law cannot go into effect until Illinois voters ratify the proposed amendment to remove the language in the Illinois Constitution that allows for only a flat rate tax structure.

21. Who can I ask for more information?

Allison Flanagan, Director of Policy Analysis (aflanagan@ctbaonline.org). Please email your questions with the subject line "Fair Tax FAQ".

For more information, contact the Center for Tax and Budget Accountability

Ralph Martire, Executive Director, (312) 332-1481 or rmartire@ctbaonline.org

Allison Flanagan, Director of Policy Analysis, (312) 332-1348 or aflanagan@ctbaonline.org

Readers of this FAQ may also be interested in CTBA's analysis of the Graduated Rate Income Tax available here.

Endnotes

[1] P.A. 101-0008, https://www.ilga.gov/legislation/publicacts/101/PDF/101-0008.pdf
[2] CTBA Analysis of (i): "FY 2009 Economic and Revenue Forecast," Commission on Government Forecasting & Accountability, March 5, 2008, 26. http://cgfa.ilga.gov/Upload/FY 2009%20Revenue%20Forecast%20SUMMARY%20MARCH%205%202008%20Meeting.pdf and (ii): "FY 2010 Economic and Revenue Forecast," Commission on Government Forecasting & Accountability, April 1, 2009, 35. http://cgfa.ilga.gov/Upload/FY 2010%20Economic%20&%20Revenue%20Update%20APRIL%201,%202009%20FINAL.pdf and (iii): "Revised FY 2020 Revenue Estimate," Commission on Government Forecasting & Accountability, May 2019, 20. http://cgfa.ilga.gov/Upload/052019UpdatedFY 2020andFY%202019RevenueEstimates.pdf and (iv): "Fiscal Year 2021 Budget Highlights," *Governor's Office of Budget & Management*, June 2020, 4. https://www2.illinois.gov/sites/budget/Documents/Budget%20Book/FY 2021-Budget-Book/21665-Fiscal_Year_2021_Budget_Highlights.pdf
[3] CTBA analysis of P.A. 101-0008 and IRS Tax Data 2017, requested via FOIA
[4] Governor's Office of Management and Budget, "State Budget Fiscal Year 2020," State of Illinois, February 20, 2019, page 35. https://www2.illinois.gov/sites/budget/Documents/Budget%20Book/FY2020-Budget-Book/Fiscal-Year-2020-Operating-Budget-Book.pdf
[5] Governor's Office of Management and Budget, "State Budget Fiscal Year 2021," State of Illinois, February 19, 2020, page 41. https://www2.illinois.gov/sites/budget/Documents/Budget%20Book/FY2021-Budget-Book/Fiscal-Year-2021-Operating-Budget-Book.pdf.
[6] Connecticut Office of Legislative Research, "Connecticut Income Tax Rates and Brackets since 1991", 2018. https://www.cga.ct.gov/2018/rpt/pdf/2018-R-0058.pdf
[7] Robert Tannenwald, Jon Shure, and Nicholas Johnson, *Tax Flight is a Myth: Higher State Taxes bring more Revenue, not more Migration* (Washington, DC: August 4, 2011), 6.
[8] Rick Pearson, "Senior groups backing graduated-rate income tax say opponents' warning that it could lead to a tax on retirement income is an attempt to confuse older people," October 7, 2020. https://www.chicagotribune.com/politics/ct-illinois-graduated-rate-income-tax-seniors-20201007-bvlz446elfc75avnpcddsuhkl4-story.html
[9] CTBA analysis of P.A. 101-0008 and IRS data, comparing joint income filing with single income filing.
[10] CTBA analysis of P.A. 101-0008 and IRS data, comparing joint income filing with single income filing.
[11] Rick Pearson, Lt. Gov. Stratton warns of 20% across-the-board income tax hike if Illinois voters reject graduated-rate constitutional amendment," *Chicago Tribune,* September 24, 2020, https://www.chicagotribune.com/politics/ct-graduated-income-tax-stratton-20200924-toniakvjejhoteplsquw6pybim-story.html.
[12] CTBA analysis of 2017 IDOR Individual Income Tax Stratification data receive via FOIA request.