

## ISSUE BRIEF

# Analysis of Berkeley Research Group Graduated Rate Income Tax Impact Report

October 21, 2020

### 1. Questionable Methodology and Lack of Transparency

On August 6, 2020, the Illinois Chamber of Commerce (“**Illinois Chamber**”) issued a press release arguing against ratification of the proposed amendment to the Illinois Constitution that will permit the state to utilize a graduated rate structure for its income tax. According to the Illinois Chamber, such ratification, coupled with implementation of the specific graduated rate structure identified in P.A. 101-0008, which is called the “**Fair Tax**” by proponents, would “somehow” shrink the Illinois economy, and disproportionately harm women and minorities.

We say “somehow,” because the press release based these claims on largely unsubstantiated findings contained in an Executive Summary of the report, “[Illinois’ Proposed Graduated Income Tax: Impacting Jobs and the Economy](#),” which the Illinois Chamber paid the Berkeley Research Group (“**BRG**”) to produce. And while the BRG claims it was given the independence needed to complete an objective analysis, somehow all of the BRG’s findings fall precisely in line with the Illinois Chamber’s positions—and contrary to much of the research on the potential economic and related impacts of implementing a graduated rate income tax, that has been conducted to date by well-known, established, and credible sources—like the Congressional Budget Office, Small Business Association, and national experts, like Nobel Prize winning, Ph.D. economist Joseph Stiglitz.

Unfortunately, the Executive Summary does not provide much in the way of support for the conclusions it reaches, nor does it regularly cite its sources, or even provide insight into the model BRG used to reach its conclusions. The Executive Summary does, however, curiously include caveats that rely heavily on assumptions that are not substantiated by prior research in the field of migration, tax burden, and economic impacts. Not disclosing data sources or assumptions for a model makes any outcomes it generates suspect, and is particularly problematic in this instance, given that the main findings contained in the Executive Summary are contrary to the body of research.

Because of these issues, our organization reached out to both the BRG and the Illinois Chamber to request a copy of the full report, so we could review its sources and the model it utilized to reach so many conclusions that run contrary to the body of research in the areas covered. However, neither the Illinois Chamber nor BRG was willing to make the full report available to either CTBA or the public. Which isn’t surprising, because, as shown in this Issue Brief, when compared to the body of research conducted by credible sources in the relevant areas, the Key Findings presented in the Executive Summary are revealed to be either inaccurate or misleading.

Following is an analysis of each of the **Key Findings** made in the Executive Summary.

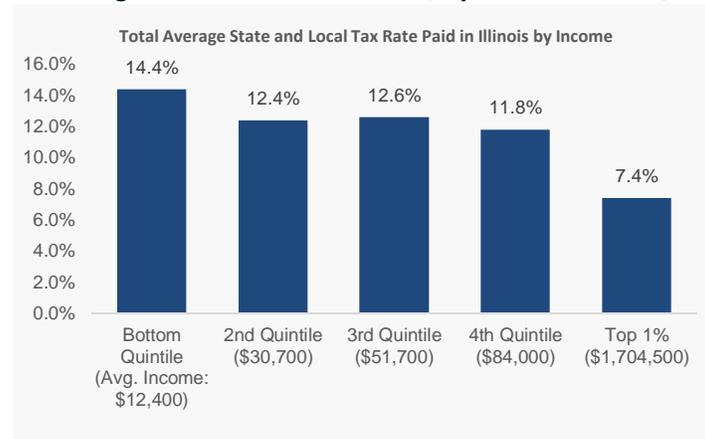
#### 1. First Key Finding: No Material Income Tax Relief—Very Misleading, But Some Credibility

Even though—for reasons that are spelled out later in this Section—it is designed to be misleading, this is one of two Key Findings that has at least some credibility. Of course, that’s only because the Fair Tax legislation was not primarily designed to provide tax relief. Instead, the main purpose of the Fair Tax legislation was to raise new revenue to help reduce the structural deficit in the Illinois General Fund in a manner that shifted tax burden from low- and middle-income workers to affluent workers. Which, in fact, the legislation accomplishes. In a normal economy that is not being ravaged by a pandemic, the Fair Tax would raise approximately \$3.6 billion in new revenue, all of which would be paid by the wealthiest three percent in the state, and none of which would be paid by low- or middle-income workers.<sup>1</sup>

**Figure 1** shows why the bi-partisan group of legislators who joined Governor Pritzker in supporting the Fair Tax wanted to raise new revenue in a manner that shifted tax burden from low- and middle-income workers to more affluent folks. It contains an

analysis of state and local tax burden in Illinois as a percentage of income, across different levels of annual earnings, that was compiled by the Institute on Taxation and Economic Policy (“ITEP”). As the ITEP analysis demonstrates, the bottom 20 percent of earners in Illinois have the highest total state and local tax burden as a percentage of income in the state, while the wealthiest one percent have the lowest.

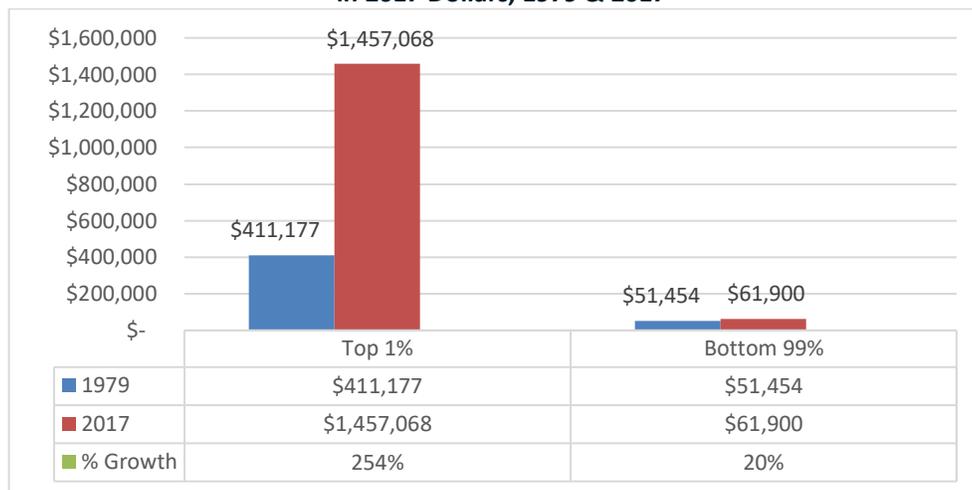
**Figure 1**  
**Total Average State and Local Tax Rate, by Income Quintile, Illinois**



Source: ITEP, “Who Pays: 6th Edition”, 2018.

It makes no sense to impose greater tax burdens on those struggling at the bottom and middle of the income distribution in the modern economy, especially given the tremendous growth in income inequality that has occurred in Illinois over the last four decades. As shown in **Figure 2**, after inflation the wealthiest one percent in Illinois have seen their average incomes spike from just over \$411,000 per year in 1979, to over \$1.4 million by 2017—an increase of 254 percent. Meanwhile the bottom 99 percent—literally everyone else—saw their average, inflation-adjusted annual incomes grow from just over \$51,000 in 1979 to just over \$61,000 in 2017, a growth rate which was ten times lower than what the wealthiest attained.

**Figure 2**  
**Average Annual Incomes of Top 1% and Bottom 99% in Illinois in 2017 Dollars, 1979 & 2017**

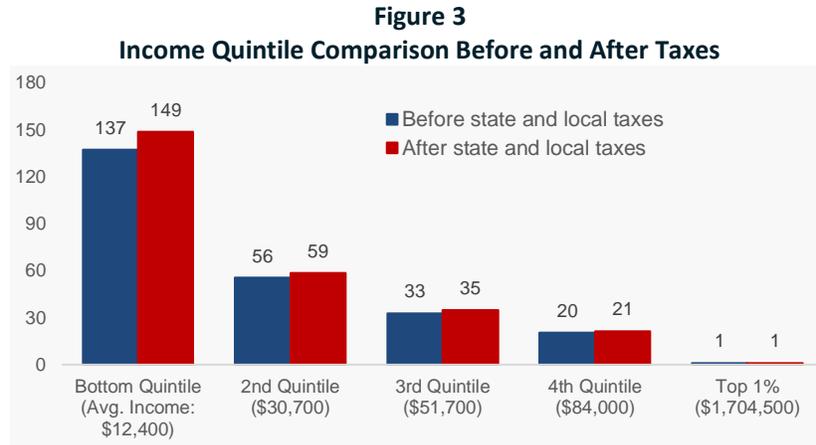


Source: CTBA analysis of IRS Statistics of Income for Illinois, 1979 & 2017, inflation-adjusted using CPI

In fact, according to Internal Revenue Service (“IRS”) data, the average income gap between the top one percent and bottom 99 percent of households in Illinois grew at the fastest rate of any state in the Midwest.<sup>2</sup> Overall, as of 2017 (the last year for which there is comprehensive data available), of all 50 states and the District of Columbia, Illinois ranked as having the 12<sup>th</sup> most unequal distribution of income.<sup>3</sup>

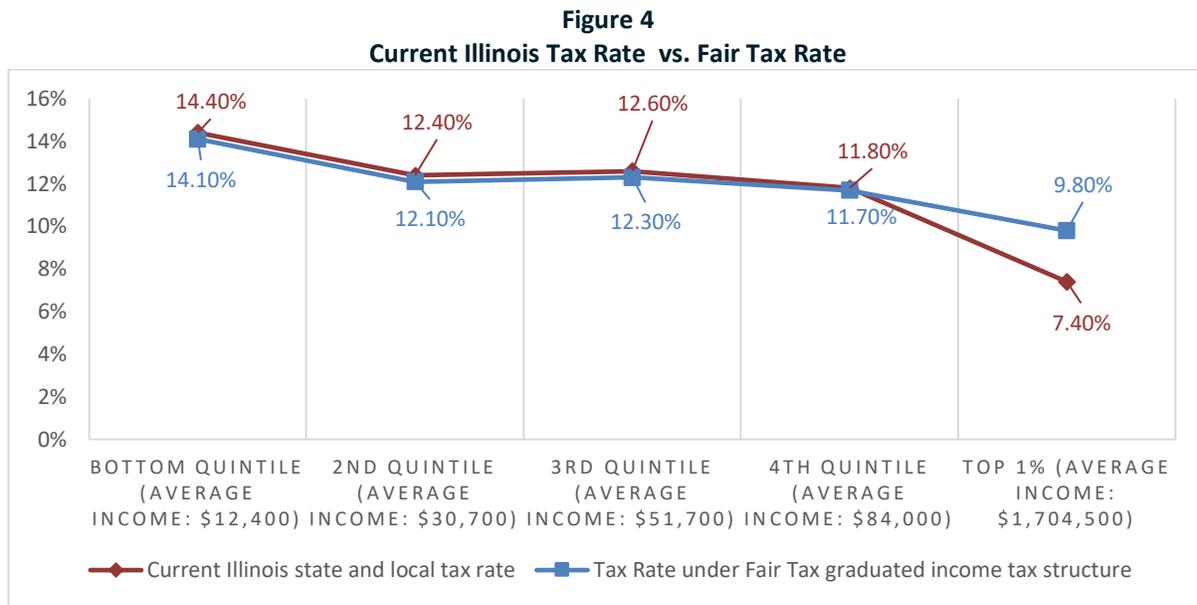
In what can best be described as piling on, the state’s current tax policy is so regressive that it makes after-tax income inequality in Illinois worse than what’s naturally happening in the private sector economy. As shown in **Figure 3**, the wealthiest one percent in Illinois have an average income that is 137 times greater than the bottom quintile BEFORE taxes. AFTER applying

Illinois state and local taxes, the differential is worse, with the top one percent having an average income that is 149 times greater than the average income of the bottom quintile.



Source: ITEP, “Who Pays: 6th Edition”, 2018.

Given that, and given the state’s clear need for revenue, the primary focus of the Fair Tax legislation—to raise new revenue in a manner that shifts tax burden from low- and middle-income earners to more affluent individuals makes complete sense. And as shown in **Figure 4**, the Fair Tax works to accomplish its intended goal.



Source: CTBA analysis of Fair Tax Amendment and ITEP, “Who Pays: 6th Edition”, 2018

But to create even more progressivity in Illinois’ tax policy, the legislation also provides \$177 million in aggregate income tax relief to the 97 percent of Illinois tax filers who have \$250,000 or less of annual taxable income.<sup>4</sup>

Since the well-financed groups opposing the Fair Tax cannot dispute that the legislation actually does precisely what its proponents claimed it would do, they instead try to obfuscate how effective the legislation is with rhetoric designed to confuse the public about both the legislation’s goals and effectiveness.

Hence, the anti-Fair Tax crowd tries to make it appear as if tax relief was a primary focus of the legislation—which it in fact never was. The sole purpose of doing this is to set up a straw man to distract voters from both the actual intent and clear effectiveness of the legislation. Then, after setting up this straw man, BRG denigrates the tax relief the legislation actually does provide as immaterial. Indeed, in its first Key Finding, BRG actually parrots some of the most common rhetoric utilized by those opposing the Fair Tax to construct this specific false narrative, by bemoaning the fact that the average tax relief “in the lower income brackets is small and might be less than a single-family meal at a fast food restaurant for many filers.” Interesting finding maybe—but entirely irrelevant in context of what the legislation was intended to do.

And while, as shown in **Figure 5**, a worker who earns \$10 an hour working full-time may only realize tax relief totaling \$25 under the Fair Tax, that amount happens to equal the pay such a worker would receive for two and a half hours on the job. Which in turn can be used for one additional meal, a refill of a tank of gas, or about one-quarter of the cost of a monthly CTA pass in Chicago.

**Figure 5**  
**Minimum Wage Worker Tax Comparison Breakdown**

Income	\$20,800
<i>Marginal Tax Bracket</i>	<i>Tax Liability</i>
4.75%	\$475
4.90%	\$529
4.95%	\$ -
<b>Total Graduated Tax Liability</b>	<b>\$1,004</b>
<b>Total Flat Tax Liability</b>	<b>\$1,030</b>
<b>Difference</b>	<b>\$25</b>

*Source: CTBA analysis of minimum wage, current Illinois tax structure, and P.A. 101-0008*

## 2. Second Key Finding: Disproportionate Job Losses—Lacks Any Credibility

The Executive Summary’s second Key Finding, that job losses would disproportionately affect women and minorities, lacks any credibility for two reasons:

First, it tries to tie job loss to a progressive tax increase, which runs counter to the body of research. **There in fact is no reason to believe implementation of the Fair Tax will create any job loss. Indeed, for the reasons outlined below in this Section, the research indicates that the opposite is true.**<sup>5</sup>

**Second, BRG’s finding that job losses will disproportionately impact women and minorities also lacks any credibility, because it is dependent on BRG’s meritless claim that a progressive tax increase results in job loss in the first place.**

**Ironically, if the Fair Tax does not pass, the service spending cuts Illinois will have to implement to help resolve the anticipated \$13.4 billion revenue shortfall in its General Fund will in fact disproportionately harm women and minorities, whom the public sector employs at higher rate than does the private sector.**<sup>6</sup>

BRG reached these unsubstantiated conclusions by claiming the four sectors of the economy that their “economic model”—the self-same model BRG and the Illinois Chamber refuse to publish or disclose any information about—indicates will be hardest hit by the tax increase, Hospitals, Restaurants, and Individual and Family Services, “tend to employ relatively more workers from these demographic groups.” The Executive Summary uses Bureau of Labor Statistics (“BLS”) data to support the contention that women and minorities are represented in greater percentages in the specific sectors of Hospitals, Restaurants, and Individual Services. That contention, at least, is accurate.

However, BRG provides no sources, data, or evidence of any kind to support its more controversial contention that the tax increase focused on the wealthy contained in the Fair Tax will result in job loss. As things currently stand, the job losses occurring in the private sector economy are primarily due to the dramatic reduction in consumer spending being caused by the pandemic.<sup>7</sup> According to recently released research conducted by Nobel Prize winning Ph.D. economist Joseph Stiglitz, along with his colleague Kitty Richards of the Roosevelt Institute at Columbia University, raising taxes progressively—as the Fair Tax does—and investing the new revenue in funding core services, actually helps create a positive private sector multiplier of anywhere from \$0.30 to \$1.50 for every tax dollar so raised and spent on services.<sup>8</sup>

Stiglitz and Richards found that during a downturn it actually makes economic sense to increase tax revenue in a progressive manner focused primarily on very high income households, and utilize that revenue to avert cutting spending on public services.<sup>9</sup> The reasons for this have everything to do with consumer spending, which accounts for roughly 67 percent of our nation’s and state’s respective.<sup>10</sup>

Because their incomes have been flat to declining on a real, inflation-adjusted basis since 1979, workers in the lower- and middle-wage quintiles tend to spend rather than save most of their earnings.<sup>11</sup> Hence in economic terms, these workers have what is called a high “**Marginal Propensity to Consume**,” or “**MPC**.”<sup>12</sup> That simply means it is likely these workers will spend every additional dollar in income they gain in the form of the modest tax relief they will receive under the Fair Tax legislation. As

noted previously, Stiglitz and Richards found that additional spending generates a positive private sector multiplier that varies from \$0.30 to \$1.50 for each additional dollar of income gained.<sup>13</sup>

Similarly, when their incomes are diminished through undue tax burden—as they are in Illinois—almost every dollar of lost income generally translates to a dollar of lost consumer spending. And reduced consumer spending has a negative multiplier effect on the private sector economy. That’s bad during a normal economy, and far worse during a recession.

More affluent individuals, however, have a low MPC. That just means when their incomes are increased or decreased, that change in income does not generally result in a corresponding change in their consumption patterns. This also should not be surprising, given that, after inflation, the wealthiest one percent of households in America have seen their inflation-adjusted incomes grow by 254 percent over the last 40 years.<sup>14</sup>

Moreover, when Illinois state government spends the newly raised revenue from the Fair Tax on funding services, most of that spending go to the four core service areas of education, healthcare human services and public safety, which collectively account for 95 percent of all state General Fund spending on current services in Illinois.<sup>15</sup> Because public services are labor intensive, this General Fund spending primarily funds the wages of the teachers, social workers, healthcare providers and correctional officers who are on the front line delivering these services in communities across Illinois. These public sector workers are all middle-income, meaning they have high Marginal Propensities to Consume—so the wages they receive from state government become spending in the local communities in which they live, which again generates a positive private sector economic multiplier.

This in turn stimulates job creation, and hence helps mitigate economic downturns like the one being caused by COVID-19.<sup>16</sup> Stiglitz and Richards made these findings based on the actual impact which making such progressive tax increases and maintaining spending on core services had on the private sector economies of states which did so in response to the Great Recession.<sup>17</sup>

In other words, when considered as a whole, the Fair Tax initiative, which supports the funding of current public services by raising new revenue from only the wealthiest three percent of households in Illinois, while concomitantly providing some modest income tax relief to everyone else, can in fact be expected to result in a positive private sector multiplier. So, rather than creating the unsubstantiated job losses suggested by BRG in the Executive Summary, the design of the Fair Tax initiative can instead be expected to support existing private sector jobs and help create new jobs.

As it turns out, Stiglitz’s findings fall in line with the vast majority of both the evidence and research in this area. Consider the evidence first. Most states that have raised taxes since 2000, particularly on the wealthiest and millionaires, saw job growth thereafter that was as strong, if not stronger, than their neighboring states that did not implement such a tax increase.<sup>18</sup> The reason: those tax increases, in fact enabled the states implementing them to increase investments in core services like education and social services, which in effect became the salaries of the teachers, social workers and other public sector workers—who in turn spent their salaries in local economies—and that enhanced consumer spending generated economic growth.<sup>19</sup>

Then there is the research. For instance, when Mark Zandi, the chief economist of Moody’s Analytics, reviewed how state fiscal actions like tax increases and spending have actually impacted the private sector economy, he reached conclusions that are substantially similar to those reached by Stiglitz and Richards.

Zandi found that historically, every dollar spent to fund core public services like education, healthcare, caring for individuals with mental health concerns or developmental disabilities or providing childcare, generates a positive multiplier of 1.36.<sup>20</sup> Under Zandi’s analysis, for every dollar spent on services by Illinois state government, Illinois’ private sector economy gets a benefit of \$1.36. Meanwhile Zandi found that tax relief targeted to low- and middle-income families generates a multiplier of roughly 1.03.<sup>21</sup> Taken together, the additional consumer and state spending that would result from implementing the graduated individual income tax rate structure contained in the Fair Tax, should generate at least 46,921 private sector jobs.<sup>22</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 the state spends \$1.3 billion on critical services, that \$1.3 billion can be expected to generate \$1.8 billion of private sector economic activity (\$1.3 billion multiplied by 1.36). If the state decides to cut \$1.3 billion of spending as a means to balance the budget, that would hurt the economy by a similar multiple. As a result, job loss has been the outcome realized by states that resorted to austerity measures like budget cuts to resolve fiscal shortcomings created by economic downturns.<sup>23</sup>

Without new revenue from the Fair Tax, the current recession—and the significant loss of revenue it has created for the state’s General Fund, will force Illinois to harm its economy by relying primarily on spending cuts to close gaps, which currently are

estimated to be more than \$13 billion by the end of FY 2021.<sup>24</sup> As indicated previously, those spending cuts will necessarily have to be focused on the wages and jobs of public sector workers who provide the public services consumed in communities across Illinois.

Ironically, women and minorities are overrepresented in public sector employment.<sup>25</sup> Hence these spending cuts would likely result in disproportionately harming women and minorities and implementation of the Fair Tax legislation would not only help prevent job retention and creation during a critical time, but it should actually disproportionately benefit women and minority workers.

**3. Third Key Finding: That the Fair Tax Will “Result in the Out-Migration of Thousands of High-Income Households”—Lacks Credibility**

**The Executive Summary finding that passage of the Fair Tax will cause the out-migration of thousands of high-income households lacks credibility for two reasons: it ignores actual out-migration trends in Illinois over the last decade; and it runs counter to the body of research in this area which consistently shows no statistically meaningful correlation between migration and tax policy.**

Indeed, to reach this finding on migration, the Executive Summary relies on the false and largely discredited assumption that tax policy changes are a statistically meaningful driver of migration.<sup>26</sup> This not only ignores the substantial body of research, but also the actual evidence of what has occurred within Illinois over the last decade.<sup>27</sup>

First, even a cursory review of the research on the number of millionaires per capita in a state reveals no statistically meaningful correlation between state income taxes and millionaire location. For instance, a study conducted in 2017 by Phoenix Marketing International, a wealth research firm, ranked U.S. states by millionaires per capita. The firm defined millionaire households as those with \$1 million or more in investable assets.<sup>28</sup> What Phoenix Marketing determined was being ranked at the top of the millionaire-ratio list appears to be as much a function of geography as policy.<sup>29</sup> As shown in **Figure 6**, the top five states in number of millionaires per capita include a no income tax state (Alaska) as well as four states that not only have graduated rate income tax structures, but also have some version of a “millionaire’s” tax (Hawaii, Maryland, and New Jersey).<sup>30</sup>

**Figure 6  
Millionaire Households Per Capita, 2017**

Rank	State	Total Households	\$1M+ in Investable Assets	Ratio Millionaires to Total Households
1	Maryland	2,263,021	178,003	7.87%
2	New Jersey	3,294,365	258,988	7.86%
3	Connecticut	1,379,979	106,892	7.75%
4	Hawaii	487,708	36,903	7.57%
5	Alaska	272,496	20,444	7.50%

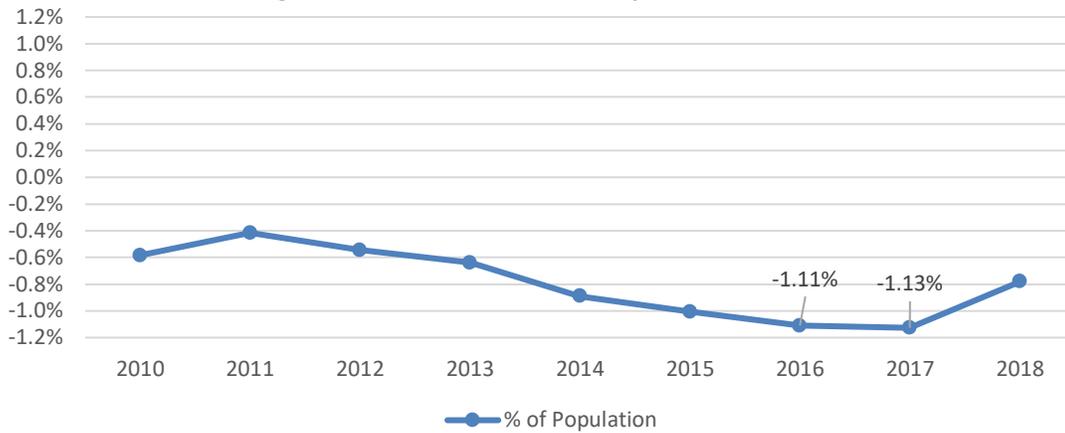
*Source: Phoenix Marketing International, Ranking of U.S. States by Millionaires per Capita, Year-End 2017 Cycle*

Then there is the Illinois specific data. If the argument claiming a causal relationship between tax policy and migration were credible, then Illinois residents should be leaving the state to move to states with lower income tax rates, or no income tax at all. However, from 2010 through 2018 just the opposite occurred. **Significantly more former Illinois residents—1.6 million—moved into states such as California, Missouri, Wisconsin, and Iowa, where the top marginal income tax rates are higher than the flat rate in Illinois, than the 1.2 million former Illinois residents who moved into states like Indiana, Texas or Florida, which either have lower income tax rates than Illinois, or no income tax whatsoever.**<sup>31</sup> This aligns with the body of research on migration which consistently finds no statistically meaningful relationship between tax policy and migration.

This trend continued in 2018, the most recent year for which there is data. **In 2018, more former Illinois residents—170,527—moved into states that had higher top income tax rates than the 4.95 percent flat rate that pertains in Illinois, than the 134,506 former Illinois residents who moved into states with lower top income tax rates.**<sup>32</sup>

As shown in **Figure 7**, out-migration of individuals leaving Illinois increased to its highest rate in the last decade over the two-year period from 2016 to 2017. Out-migration then decreased significantly in 2018.

**Figure 7**  
**Migration Rate as a Percent of Population for Illinois**

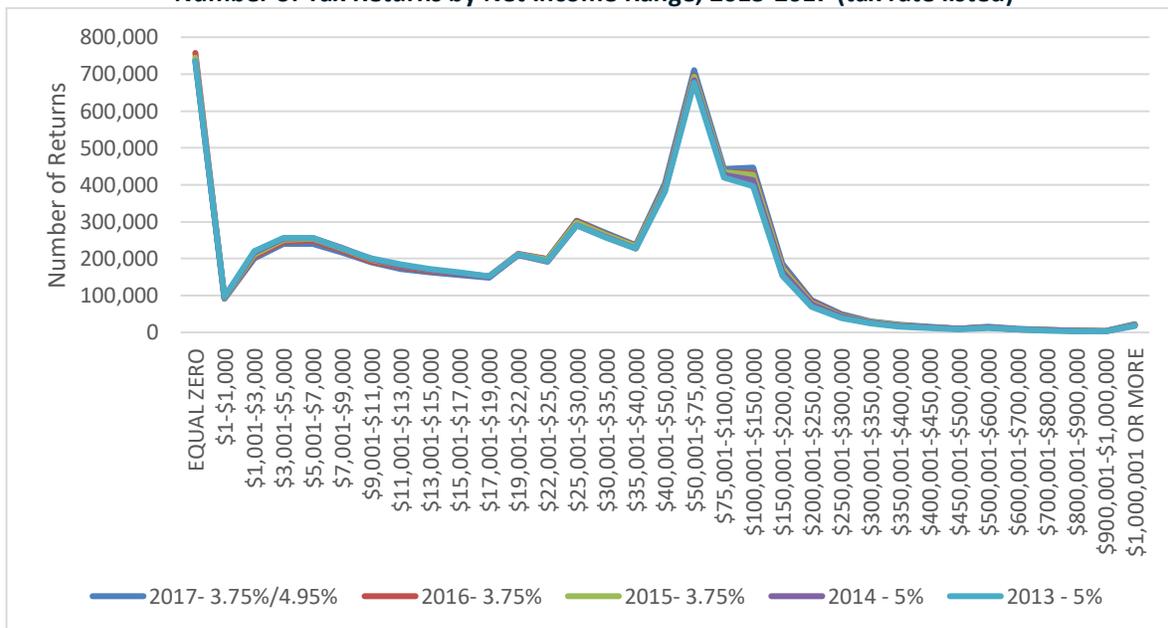


Source: U.S. Census Geographic Mobility Data

That is notable because beginning in 2015 and continuing halfway through 2017, the state’s income tax rate had been decreased from five percent to 3.75 percent, which was the income tax rate in 2014.<sup>33</sup> Moreover, in 2018, when out-migration away from Illinois shrunk to negative 0.78 percent, the income tax rate was increased to its current level of 4.95 percent.<sup>34</sup> This real-world experience in Illinois runs directly counter to the false assumption relied on in the Executive Summary, i.e. that increases in income tax rates cause migration out on the one hand, while cutting income tax rates encourages people not to leave.

That migration data is consistent with Illinois Department of Revenue (“IDOR”) data concerning tax returns filed in Illinois. As shown in **Figure 8**, the number of tax returns filed remained relatively stable over the 2013-2017 sequence, irrespective of two separate tax changes—one a tax decrease and one a tax increase.<sup>35</sup> Hence much like overall migration, changes in the number of returns filed in Illinois does not correlate with tax policy changes. In fact, in 2017, when the income tax rate increased, fewer tax returns were filed by low-income households, and more income tax returns were filed by middle- and high-income households.<sup>36</sup>

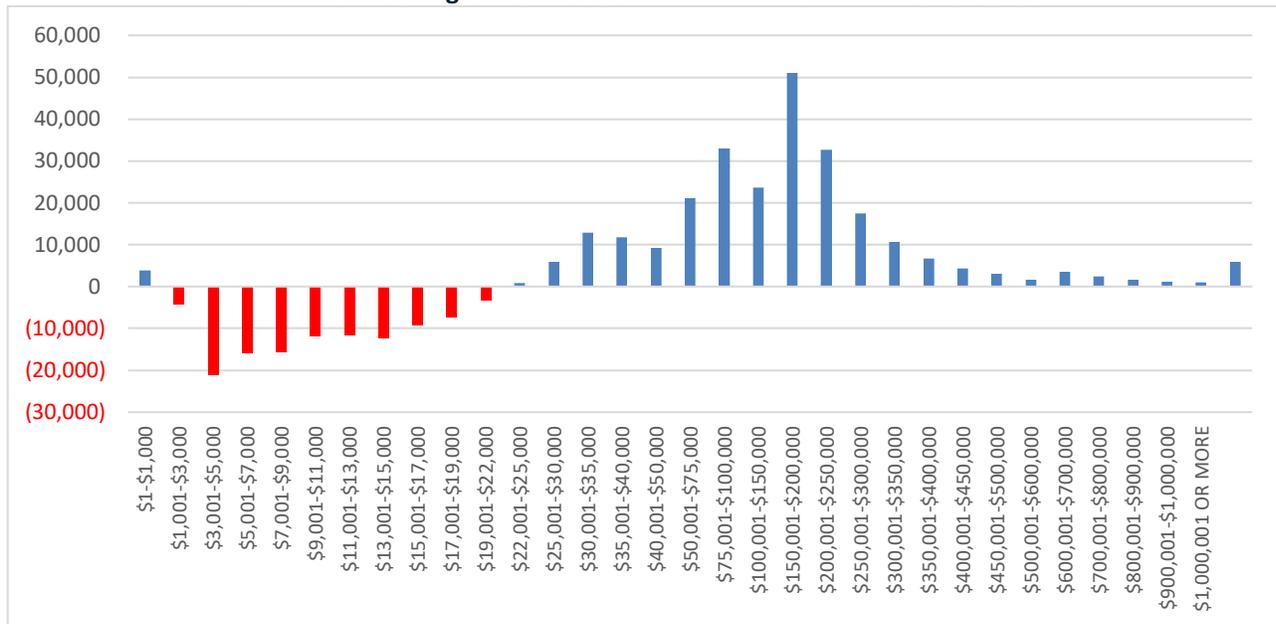
**Figure 8**  
**Number of Tax Returns by Net Income Range, 2013-2017 (tax rate listed)**



Source: IDOR Net Income Stratification data, 2013-2017.

Overall, since 2013, Illinois has realized a net increase of about 6,000 households with after-tax income above \$1 million. Meanwhile, over that same period there was a net decrease in households with after-tax income below \$22,000, as shown in **Figure 9**.

**Figure 9**  
**Cumulative Change in After-Tax Income Returns between 2013-2017**



Source: IDOR Net Income Stratification data, 2013-2017.

The Executive Summary expressly states its findings concerning out-migration of high-income households are predicated on a model of out-migration in California which erroneously assumed tax policy caused out-migration in that state.<sup>37</sup> The experience in Illinois exposes this false assumption for the canard it is.

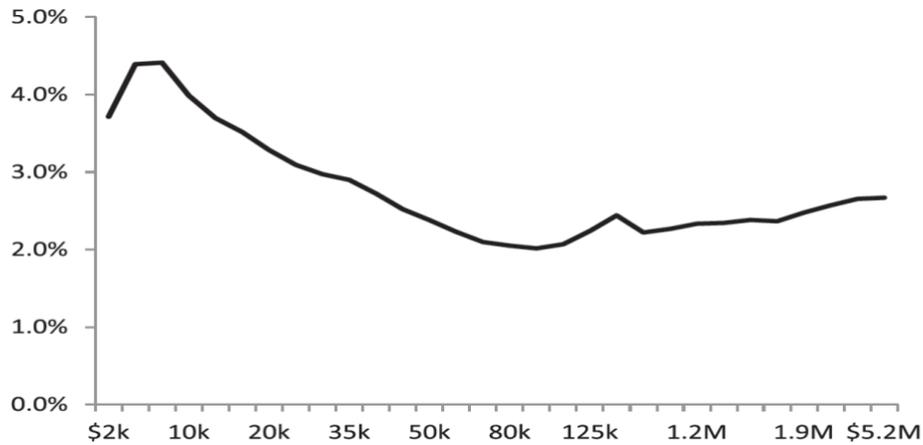
Of course, the actual experience in Illinois should come as no surprise, given that most of the research in the area of migration finds that, while people of all income levels move for many complicated, interrelated reasons, tax policy is not a statistically meaningful reason why. Instead, the main reasons the research indicates people move to a different state are employment, family-related matters, and education.<sup>38</sup> Indeed one study, done by Jeffrey Thompson of the Political and Economic Research Institute at University of Massachusetts Amherst, found that “nearly 9 in 10 working age adults relocate for jobs, housing, and family related reasons.”<sup>39</sup>

Another study conducted by the PEW Research Center, which surveyed American households, confirmed that family ties are a major reason people do not leave their hometowns. Other top reasons cited were a sense of belonging, connection to friends, and having a good place to raise children.<sup>40</sup> Similar conclusions were recently reached in a book, *The Myth of Millionaire Tax Flight*, published by Stanford University Professor Cristobal Young, who has spent the last decade studying migration trends.

In his book, Young found only 2.4 percent of millionaires—or 165,000 millionaires—migrated during the period between 1999 and 2011.<sup>41</sup> A statistically insignificant number of those millionaires who moved, 0.3 percent—or 20,000—did so for tax reasons.<sup>42</sup> Which was the basis of Young’s finding that, of the population that chooses to relocate, the number that relocates for reasons related to taxes is insignificant to tax policy.<sup>43</sup>

Overall, Young found that households on the lower end of the income distribution had the highest migration at high rates, shown in **Figure 10**.

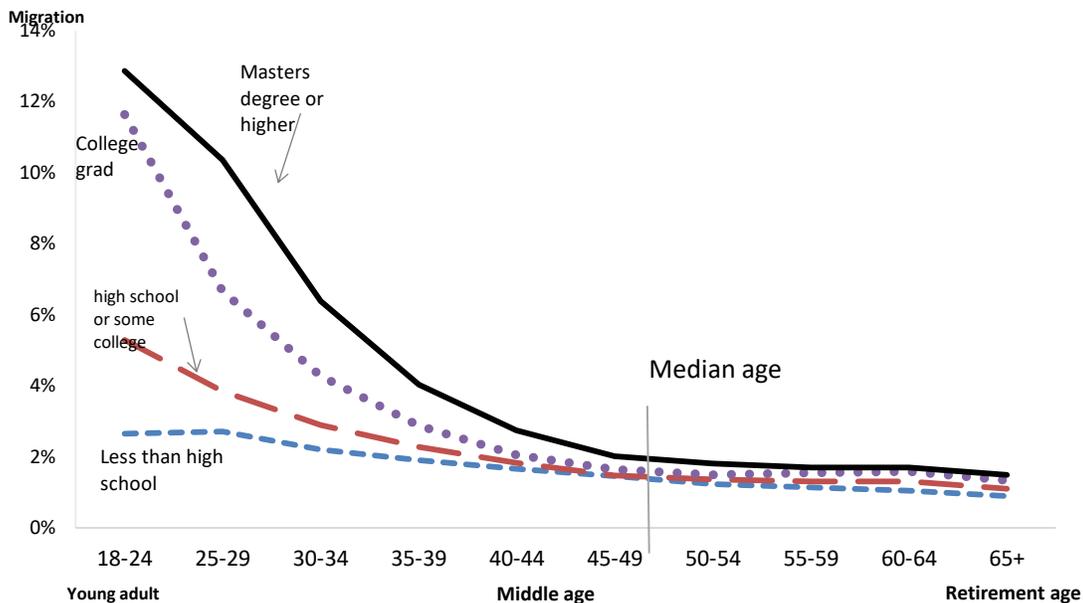
**Figure 10**  
**Migration Rates by Income, 1991-2011**



Source: Cristobal Young, *The Myth of Millionaire Tax Flight*, 2017

Moreover, Young found that migration rates actually decreased with age and education. Those with a master’s degree or higher between the ages of 18-29 had the highest rate of mobility, as shown in **Figure 11**.

**Figure 11**  
**Migration Rates by Age, For Different Education Groups, 2005-2014**



Source: Cristobal Young, *The Myth of Millionaire Tax Flight*, 2017.

Young further found that by middle-age, or about a decade before peak income level, all individuals irrespective of educational attainment align at a migration rate of around 2 percent.<sup>44</sup> Young concluded that this data demonstrated millionaires, like all other people, value place-specific social capital.<sup>45</sup>

Indeed, numerous studies show that the vast majority of individuals are drawn to states that have strong public services, which are paid for by tax dollars.<sup>46</sup> One study in particular, released by the Center on Budget and Policy Priorities (“CBPP”), found that “amenities such as cultural facilities, recreational opportunities and well managed public services” attract potential new residents.<sup>47</sup> Well-funded public education matters as well.<sup>48</sup> This suggests that, contrary to the findings in the Executive Summary, and consistent with the body of research in this area, when Illinois raises new revenue through the Fair Tax to invest in core services like education, it is more likely to encourage families to remain in, rather than migrate out of the state.

#### 4. Fourth Key Finding: Reduction in GDP—Lacks Credibility and Runs Counter to Well Established Research

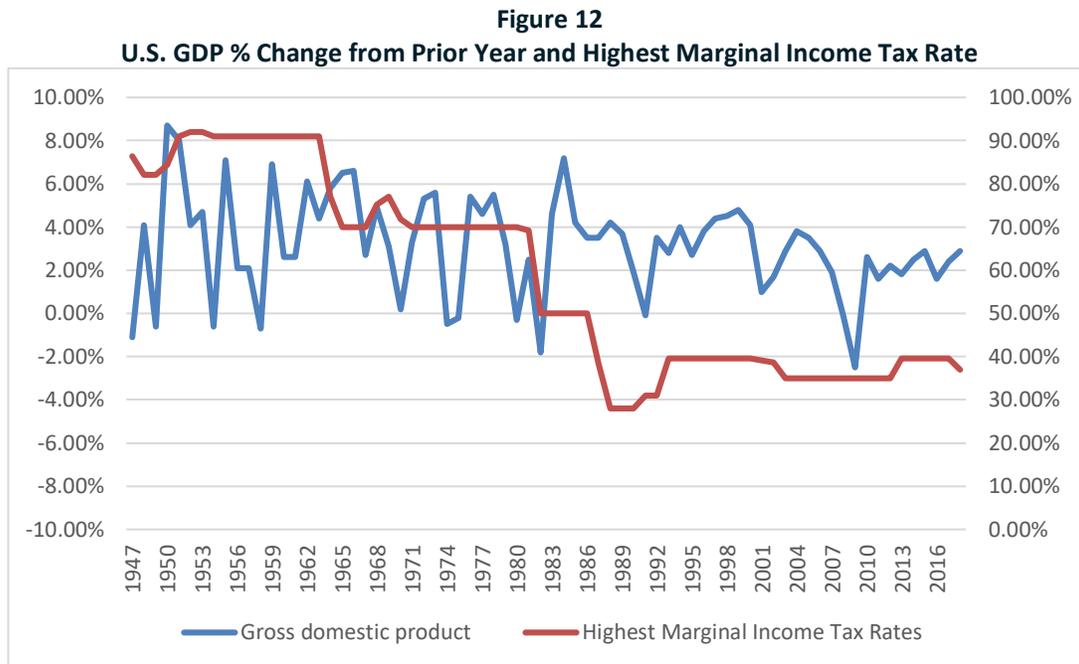
The Executive Summary’s fourth Key Finding that ratification of the Fair Tax will “cause up to a \$1.8 billion reduction in the income of Illinois residents annually, as measured by the state’s GDP lacks any credibility for two reasons:

**First, it cites no authority for reaching this finding, nor does it provide any insight whatsoever into the model used, data drawn upon, nor the assumptions underlying this finding.**

**Second, it runs contrary to the body of research done in this area, including recent analyses of the interplay of progressive tax increases and private sector economic activity completed by both Nobel Prize winning economist Joseph Stiglitz, as well as Mark Zandi, the chief economist at Moody’s Analytics.**

Continuing a pattern, the Executive Summary fails to provide any information to support its claim that the Fair Tax will somehow lead to a reduction in GDP or income in the state—as this finding seems to conflate those quite disparate items. To be clear, the Executive Summary fails to provide: any explication of its model; any identification of assumptions; or any reference to methodologies or data utilized.

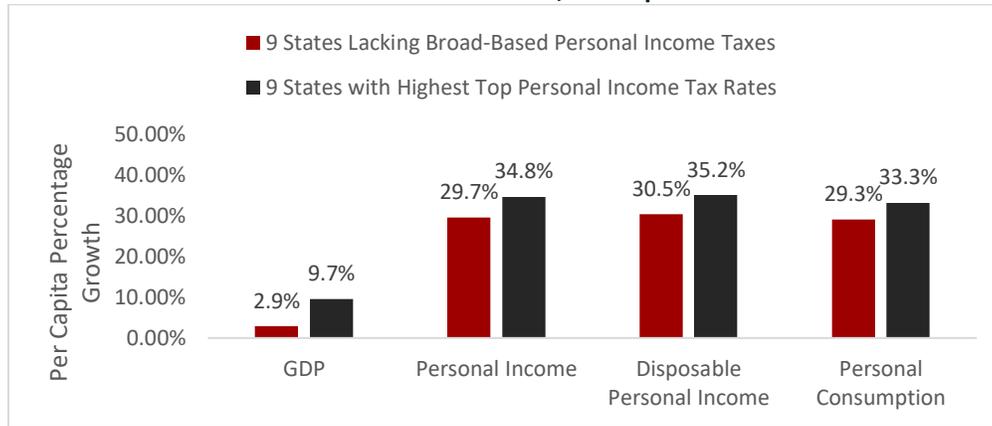
Moreover, this finding also runs counter to the body of evidence and research in the area. For example, as shown in **Figure 12**, there is no statistically meaningful correlation between changes made in the top federal income tax rate and changes in rate of GDP growth nationally going all the way back to the end of World War II.<sup>49</sup>



Source: CTBA analysis of BEA Historical GDP data and Tax Policy Center - Urban Institute and Brookings Historical Highest Marginal Tax Rates

This is consistent with research published by ITEP that analyzed how the nine states in America 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: per capita real gross state product growth; real median income growth; and employment growth.<sup>50</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. A CTBA update of that study found that over the period from 2008 through 2018, **the states with the highest individual income tax rates realized greater growth in real, per capita gross state product than their non-tax peers (9.7% to 2.9%)**, as well as greater gains in real personal and disposable income (approximately 35% to 30%), as shown in **Figure 13**.

**Figure 13**  
**Economic Growth in the States, Per Capita 2008-2018**



Source: CTBA Analysis of BEA Regional data

Indeed, as detailed in Section 2 of this report, both Stiglitz and Zandi found that when state governments raise taxes progressively—as the Fair Tax would do—and utilize the revenue from said tax increases to maintain or enhance spending on core services, the net impact on the economy is growth, not decline, because of the net increase in consumer spending created thereby. Growing economies simply do not create a loss of income.<sup>51</sup>

Now, consider the particulars of the Fair Tax itself. If implemented, the legislation would raise approximately \$3.6 billion in new income tax revenue in a normal, non-COVID-19 economy, and approximately \$1.4 billion in the portion of FY 2021 during which it would pertain.<sup>52</sup> The entire tax increase under the Fair Tax would be paid by the wealthiest three percent of income earners in Illinois.<sup>53</sup> That level of a tax increase imposed on the wealthiest three percent cannot be expected to diminish their consumption patterns, given their low MPCs.<sup>54</sup>

To understand why this tax increase is unlikely to diminish their spending in the consumer economy, consider that in 2017, the wealthiest three percent of income earners realized a \$16 billion year-to-year increase in their *after-tax income*, over 2016 levels, as shown in **Figure 14**.<sup>55</sup>

**Figure 14**  
**Change in Tax Returns and after-tax income 2016 to 2017**

Income Range	Percent of Taxpayers	# of Taxpayers	Change in after-tax income from 2016	Average change in net income per taxpayer
\$0-\$250,000	97%	6,049,980	\$6,149,229,257	\$1,016
\$250,001 and more	3%	189,133	\$16,873,734,171	\$89,216

Source: CTBA analysis of IDOR Net Income data

Which means that potential \$1.8 billion reduction in disposable income for the wealthiest three percent of taxpayers in FY 2021, represents only 11 percent of the *growth in disposable income* that they actually realized between 2016 in 2017. Bottom line, if the Fair Tax were fully implemented in 2017, the after-tax earnings of the wealthiest three percent in Illinois would have still increased by \$13.27 billion over 2016 levels, for an average growth in year-to-year disposable income in excess of \$70,000 each.

**5. Fifth Key Finding: “Higher Corporate Taxes Will Be Passed on To Consumers”—Is Somewhat Credible but The Findings That Illinois’ Corporate Income Tax Rates Would Be The Second Highest In The Country And That Illinois “Ranks Near The Top In Terms Of State Tax Burden Imposed On Its Residents” Both Lack Credibility, Are Designed To Mislead The Public, and Ignore Fundamental Aspects of Tax Policy**

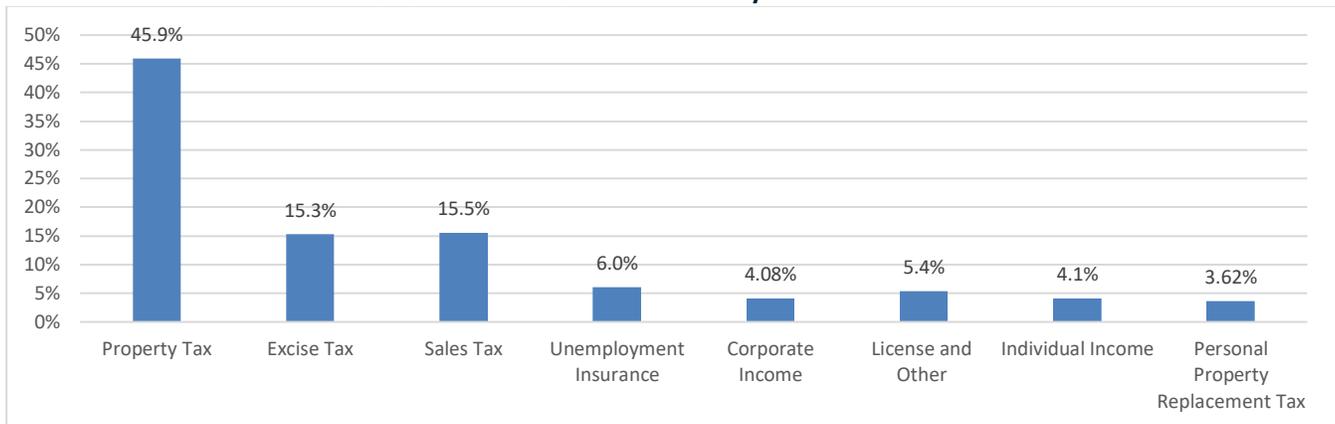
The Executive Summary’s finding that “some portion of revenues (\$332 million) arising from an increase in the corporate tax rate would be passed on to suppliers and customers, increasing prices on goods and services” is somewhat credible, as businesses tend to pass on to customers any cost increases realized, in an effort to maintain profit margins. That said, the \$332 million increase in corporate tax revenue projected to be generated by the Fair Tax is insignificant, as it would represent an

increase of just one percent in total business tax burden in Illinois (\$33.5 billion), and would not even be a rounding error when compared to the state's GDP of \$885 billion.<sup>56</sup>

In fact, as shown in **Figure 15**, the corporate income tax in Illinois accounts for just 4 percent of total business tax burden in the state. Because the corporate level tax increase under the Fair Tax is so insignificant, it cannot be expected to have any material impact on the cost of services or products in the Illinois economy.

Moreover, while it is likely there will be some shift of this minor increase in corporate income tax burden to consumers, the trade-off for consumers is between the minor increase in the cost of private goods and service therefrom, and the increase in value of the public sector services funded with said additional corporate tax revenue.

**Figure 15**  
**FY 2018 State and Local Fees Paid by Businesses in Illinois**



Sources: *Total State and Local Business Taxes: State-by-state estimates for fiscal year 2018* (Washington, DC: Ernst & Young and Council on State Taxation, July 2019), 10; *Illinois Department of Revenue, FY 2019 Estimate for Replacement Taxes*.

**The Executive Summary's finding that "the corporate tax rate will increase from 9.5% to 10.49% (an increase of 10%), the second highest in the country," as well as the claim that Illinois places a high tax burden on its residents, both lack credibility and are intentionally designed to mislead the public.**

First and foremost, the corporate income tax rate in Illinois is seven percent, not the 9.5 percent cited in the Executive Summary. If the Fair Tax is implemented, that rate will increase to 7.99 percent, not the 10.49 percent cited in the Executive Summary,<sup>57</sup> a change in rate of .99 percent, or less than one whole percentage point. As shown in Figure 15, the corporate income tax represents a very small portion of business tax burden in Illinois.

The Executive Summary, however, attempts to deceive the public into believing the state's income tax rate is currently 9.5 percent, rather than the seven percent it actually is, by including the local Personal Property Replacement Tax ("PPRT") in with the state income tax.

The PPRT was established in 1979 to fund local government services. As the name suggests, the PPRT replaced the personal property tax local governments formerly assessed against businesses. The former personal property tax was based on the value of items utilized in the production of a business's products or services. Forty-two states and the District of Columbia still assess a local personal property tax against business.<sup>58</sup> From an administrative standpoint, the PPRT is technically collected by the state—but then disbursed in full to local governments across Illinois.

Unlike the Illinois state income tax, which exempts all businesses other than "C-Corporations" from taxation irrespective of profitability, partnerships, trusts, LLCs, S-Corps, and C-Corps alike are subject to the PPRT. The PPRT assessed varies by business type, however, with C-Corps paying 2.5 percent of net profits; and partnerships, trusts, most LLC's and S-Corps paying 1.5 percent of net profits.<sup>59</sup>

Businesses supported creation of the PPRT, because it is a much better way to tax businesses than imposing a personal property tax. That is because the PPRT is only assessed after a business has earned enough revenue to cover all its costs of operation, plus generate a profit. A personal property tax, however, is assessed irrespective of the profitability of a business, and acts as more of a fixed cost that has to be paid even when a business is not generating adequate sales revenue to be profitable.

For reporting purposes only, the Illinois Department of Revenue refers to the state's corporate income tax and the local-only PPRT collectively as "business income taxes."<sup>60</sup> However, while both taxes are based on business profits, they are not both

state-level income taxes. The revenue generated by the PPRT does not benefit state government. Instead, it is a purely local revenue source—like the property tax is now, and the former personal property tax was before being replaced by the PPRT.

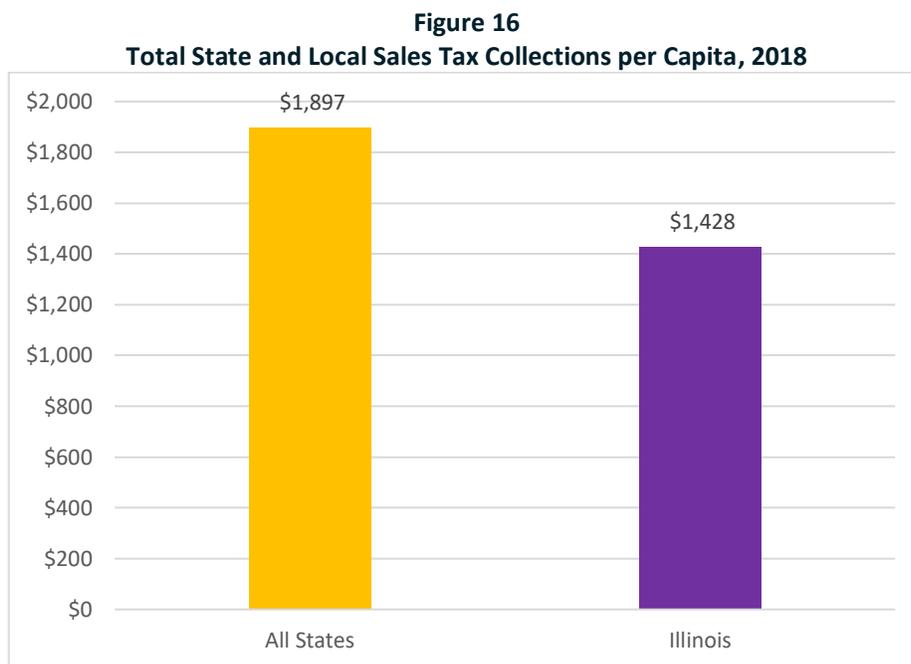
Because of IDOR'S reporting, the local PPRT tax rate is often incorrectly combined with the state's corporate income tax rate when comparisons of state-level corporate income taxes are made—as is done in the Executive Summary. This erroneously overstates the state corporate income tax rate in Illinois, which in turn skews national comparisons, as the combined local PPRT/state corporate income tax rate in Illinois is contrasted with state level only corporate income tax rates applicable elsewhere.

**Such comparisons not only mislead the public by artificially inflating the Illinois state corporate income tax rate vis-à-vis other states, they also create an apples-to-oranges dichotomy for one simple reason: they include the PPRT assessed in Illinois—yet fail to include the personal property taxes that are still assessed in the vast majority of other states.**

Indeed, the entire analysis of tax policy in the Executive Summary is designed to mislead the public and misrepresent the facts. For instance, the Executive Summary makes the unsubstantiated claim that Illinois “ranks near the top in terms of state tax burden imposed on its residents.” Nothing could be further from the truth. According to the Federation of Tax Administrators, which does not do modeling but simply reports final data contained in the audited financial statements of state governments, Illinois ranks 33<sup>rd</sup> in total state and local tax burden as a percentage of income—despite having the sixth largest population and fifth largest economy of any state in America.<sup>61</sup>

The authors of the Executive Summary were so intent on pleasing the Illinois Chamber which funded their work, that they intentionally ignored a key aspect of tax policy to make it appear as if sales taxes in Illinois are high. Specifically, the Executive Summary, in trying to make its false case that Illinois is high tax seem believable, noted that Illinois has the “sixth highest weighted average sales tax rate (9.08%)” in the country. To be clear, the state sales tax rate in Illinois is five percent, which is middling compared to other states, while the local sales tax rate in Illinois is generally 1.5 percent.<sup>62</sup> Then home rule governments like Cook County and Chicago, and a few other local governments, have increased their local sales rate above the 1.5 percent standard applicable throughout most of Illinois.

But distorting the actual state sales rate is not the main deception used by the authors of the Executive Summary to make Illinois' sales tax burden seem high when compared to other states. Instead, they simply omit any discussion of the state of Illinois' sale tax base. The base of a tax is simply what the tax is applied to—so the base of a sales tax includes solely those products and services the sale of which are taxed. The authors of the Executive Summary chose to omit discussion of the sales tax base in Illinois, because once the base is included, the sales tax revenue actually raised in Illinois on a per-capita basis is the lowest in the country, as shown in **Figure 16**.<sup>63</sup>



*Source: Federation of Tax Administrators, 2018; Delaware, Montana, New Hampshire, and Oregon do not levy state sales taxes and are therefore excluded from the analysis.*

## 6. The Final Point

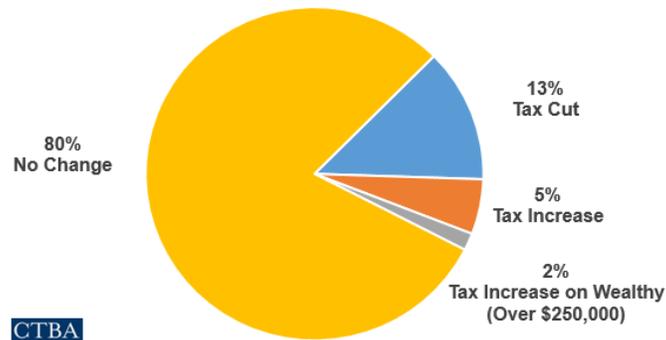
Ultimately, the Executive Summary provides insufficient detail about the model used to determine its various negative findings about the impact of the Fair Tax. It does, however, divulge that the model utilized data points from some states with graduated income tax systems, like California and Connecticut, that have increased the number of tax brackets and corresponding tax rates they utilize over time. However, California is the greatest contributor (approximately 14.6 percent) to the U.S. GDP and has the highest marginal tax rate in the country. It also ranks last out of all 50 states and the District of Columbia on the ITEP Tax Inequality Index, meaning it has the fairest state tax structure in the country.<sup>64</sup>

Meanwhile, Connecticut has updated and amended its income tax structure eight times in the last 25 years, because the state's tax system is not designed to respond to the loss of jobs and industry that state has been experiencing. For instance, in the 1980s, the manufacturing industry accounted for 28.3 percent of Connecticut's GDP, but that dropped to about 19 percent by the 1990s.<sup>65</sup> Connecticut was uniquely dependent on the defense industry. That has proven problematic for the state ever since the fall of the Berlin Wall in 1989, which has resulted in Connecticut realizing slow economic growth due to a material decrease in its national defense manufacturing contracts, a financial recession that hit the state in the early 1990s, and a natural disaster (hurricane) in 1992 that caused Connecticut to restructure one of the largest industries for the state: insurance.<sup>66</sup> All of this is to say that Connecticut has adjusted its graduated rate income tax structure to try and generate sustainable revenue despite its various economic and other challenges that have resulted in quite slow employment growth.

Drawing on the Connecticut example, the Executive Summary makes the supposition that, because the anticipated revenues from the Fair Tax would not "come close to offsetting the annual budget deficit and the amount of debt the Illinois government has incurred," it would be reasonable to assume that Illinois will increase income tax rates and brackets in the future. However, to reach this conclusion the Executive Summary had to rely on outlier states like Connecticut and California, which did change income tax rates and brackets—while most other states with a graduated rate structure did not.

In fact, since 2003, states with graduated rate income taxes have cut rates on the middle class nearly two and a half times more often than they have raised them. In any given year, a state with a graduated income tax had a roughly 13 percent likelihood of cutting taxes—versus just a five percent likelihood of increasing them on the middle class, as seen in **Figure 17**.

**Figure 17**  
**States with Graduated Income Taxes Are More Than Twice As Likely to Cut Taxes on the Middle Class Than Raise Them, Annual Likelihood of Change, 2003-2019**



Source: CTBA analysis of Tax Foundation data.

Indeed, based on what all 32 states with a graduated rate income tax have actually done, the data show that there is an 80 percent likelihood that states with a graduated rate income tax structure will not change their tax rates on the middle class at all.

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Readers of this Issue Brief may also be interested in CTBA's analysis of the Graduated Rate Income Tax [available here](#).

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## ENDNOTES

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<sup>57</sup> Public Act 101-0008, <https://www.ilga.gov/legislation/publicacts/101/PDF/101-0008.pdf>

<sup>58</sup> Garrett Watson, "States Should Continue to Reform Taxes on Tangible Personal Property," August 6, 2019, <https://taxfoundation.org/tangible-personal-property-tax/>

<sup>59</sup> 30 ILCS 115/12. In addition, public utilities pay a specific replacement tax in an amount equal to 0.8 percent tax on invested capital. Other replacement taxes include the Electricity Distribution Tax and Telecommunications Infrastructure Maintenance Fee. \*In Illinois, Limited Liability companies ARE NOT ASSIGNED A SPECIFIC TAX RATE FOR the Personal property Replacement Tax. INSTEAD, LLCs can choose to be taxed at either the HIGHER C-Corp RATE or LOWER S-corp/partnership rate, AND ARE REPORTED UNDER THE CATEGORY THEY SELF-SELECT. it can reasonably be assumed THAT THE VAST MAJORITY OF these businesses would SELF-SELECT THE LOWER rates applicable to partnerships and S-corporations, AND HENCE Preliminarily BE INCLUDED IN THOSE categories.

<sup>60</sup> Illinois Department of Revenue, *Analysis of Selected Illinois Business Tax Incentives* (Springfield, IL; April 2009) 5.

<sup>61</sup> Federation of Tax Administrators, "2018 State and Local Tax Burden as a Percentage of Income," <https://www.taxadmin.org/2018-state-and-local-revenue-as-a-percentage-of-personal-income>.

<sup>62</sup> Illinois Department of Revenue, "Locally Imposed Sales Taxes Administered by the Illinois Department of Revenue," <https://www2.illinois.gov/rev/research/publications/Documents/localgovernment/st-62.pdf>.

<sup>63</sup> CTBA analysis of Federation of Tax Administrators, 2018 State and Local Revenue Per Capita and 2018 State and Local Tax Collection by Source, <https://www.taxadmin.org/revenues-and-burdens>

<sup>64</sup> Institute on Taxation and Economic Policy, "Who Pays," October 2018, <https://itep.sfo2.digitaloceanspaces.com/whopays-ITEP-2018.pdf>.

<sup>65</sup> Wesley Tharpe, "Raising State Income Tax Rates at the Top a Sensible Way to Fund Key Investments," *Center on Budget and Policy Priorities*, February 7, 2019, <https://www.cbpp.org/sites/default/files/atoms/files/2-7-19sfp.pdf>.

<sup>66</sup> 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>