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Executive Summary: Illinois Should Enhance its Earned Income Tax Credit and Create a Child Tax Credit

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1. Earned Income Tax Credit and Child Tax Credit Basics

Both the federal government and the State of Illinois allow qualified taxpayers to claim an Earned Income Tax Credit ("**EITC**") on their respective income tax returns. The EITC rewards work and reduces poverty by targeting tax relief to low-income families with children. The EITC has become one of the more effective anti-poverty programs in the United States,[1] because it is a "refundable" tax credit. When a tax credit is **"refundable,"** the taxpayer receiving it gets the full dollar value of the credit, even if that dollar value exceeds the income tax liability said taxpayer owes.

Because it boosts the earnings of workers who receive it, the EITC increases their purchasing power. And because lower wage workers tend to spend rather than save any increases in income—including income enhancements from tax credits—that additional spending stimulates private sector growth in local economies.

Moreover, the refundability feature of the EITC helps make tax burden more progressive—and hence fairer—because the cash refund it generates partially offsets the impact of many taxes, like sales, property, and excise, which low- and lower-middle-income workers' pay in addition to the income tax.

These economic, tax and anti-poverty benefits are created at a relatively low cost for the state—roughly $400 million in nominal dollars in FY 2019.[2] For context, that equates to approximately **one-percent** of the total revenue Illinois realized in its FY 2019 General Fund.[3]

The federal Child Tax Credit ("**CTC**") initially provided qualified taxpayers with a $400 per child nonrefundable credit, and was intended to provide tax relief to middle-income families.[4] In 2001, the feds made the CTC refundable. That in turn allowed the federal CTC to help both reduce poverty and make tax policy fairer, similar to the EITC. [5] Illinois currently does not have a CTC at the state level.

2. Making Tax Burden Fairer in Illinois is Sound and Needed Public Policy

The refundability feature of the EITC is a very effective, as well as administratively facile, way to make tax burden fairer in Illinois. This is a sound and needed policy outcome, given that the state's current tax policy is highly regressive, and income inequality has worsened significantly in Illinois over the last four decades.

In fact, Illinois is consistently one of the most regressive, and hence unfair taxing states in America, and currently ranks as the 8th most regressive taxing state in the nation.[6] Hence, any initiative that lessens tax burden for low- to middle-income working families—like the existing state EITC or creation of a new refundable CTC in Illinois—constitutes a positive step forward from a tax fairness standpoint.

Taking that step forward is especially crucial now, given the long-term trend of worsening income inequality in Illinois. Consider that, from 1979 to 2018, the wealthiest one percent of Illinois households saw their average, annual income after inflation grow by 254 percent, while the remaining 99 percent realized an average increase of just 20 percent.[7]

Given the growth in income inequality that has manifested over the last few decades, making tax burden fairer requires shifting tax burden from low- and middle-income earners to more affluent earners. In tax policy speak, that means shifting from a "regressive" tax system (i.e., a system where tax burden as a percentage of income is greater for low- and middle-income individuals than for affluent individuals) to a more progressive tax system (i.e. a system where tax burden as a percentage of income increases as annual income increases).

3. Impact of Recent Federal Enhancements of the EITC and CTC

As a response to the COVID-19 pandemic, which disproportionately impacted low- and middle-income individuals and families, Congress and President Biden included enhancements of the federal EITC and CTC in the American Rescue Plan Act, or "**ARPA**."

These enhancements of the CTC and EITC under ARPA had profound impacts in Illinois from both economic and social justice standpoints. Overall:

- 89 percent of all Illinois children aged 17 and under (2,543,000 in all) benefit from either the increase in age eligibility under, and/or enhanced dollar value of, the CTC;[8]
- Of that group, over 50 percent of the children aged 17 and under (1,305,000 in all) who benefit are a race other than white;[9]
- In addition, 63 percent of the 986,000 children in Illinois aged 16 or under who benefit from the enhanced dollar value of the CTC under ARPA are from Black and Brown households;[10] and
- an additional 616,000 individuals in Illinois benefited from the ARPA expansion of EITC eligibility to include more workers without children.[11] Of that amount, 39 percent were people of color.[12]

Providing the aforesaid benefits to lower income and no income individuals in Illinois makes sense because of the economic impact COVID-19 has had on these populations. According to a U.S. Census Bureau survey, 17 percent of adults in Illinois rental housing reported not being caught up on rent, while 26 percent of adults in Illinois reported difficulty covering usual household expenses such as purchasing food, paying rent or mortgages, making car payments, and covering medical expenses.[13] According to that same survey, households with children had even more trouble paying such usual household expenses than households without children.

The number of households experiencing difficulty in paying these typical expenses fell quickly after the implementation of ARPA. Initially, this was due to the $1,400 in direct payments made to qualified households under ARPA.[14] However, the number of households experiencing difficulty paying typical expenses fell again after families began receiving expanded monthly CTC benefits under ARPA.[15] Which means Illinois decision makers can anticipate that expanding the state's EITC and creating a CTC in Illinois for the first time would effectively help lessen many of the economic difficulties Illinois households now face.

3. HB 4920/SB 3774—a Proposal to Enhance Illinois' Existing State EITC and Create a New State Level CTC

Under HB 4920/SB 3774—the "**Tax Equity Initiative**"—eligibility to claim the Illinois state EITC would be expanded to include individuals over the age of 65 without children, childless taxpayers between the ages of 18-24, and taxpayers using a tax identification number ("**ITIN**").[16]

The Tax Equity Initiative also creates an eligible dependent tax credit, but not in the same form as the federal CTC. For instance, while the definition of a child 'dependent' contained in the Tax Equity Initiative is based on IRS criteria for federal tax purposes, the benefit provided by the proposed new state-level CTC is not contingent on the number of dependents a family has. Instead, the new state-level CTC would provide a fully refundable credit of $600 to each individual with no income who serves as an unpaid caregiver for at least one child aged 17 or younger.[17]

The Tax Equity Initiative also provides that at a minimum, an unpaid caregiver of children aged 17 and under who is eligible to claim benefits under the state's expanded EITC and newly created CTC, shall receive a combined benefit worth at least $600 in any year.[18]

The projected annual cost of implementing the Tax Equity Initiative after all benefits are phased in is **$415 million.** For context, that cost represents less than one percent of the net, recurring General Fund revenue Illinois projects for FY 2022—even after deducting all federal relief support the state is receiving under ARPA.[19]

4. Private Sector Economic Benefits of Passing the Tax Equity Initiative

Creating a state-level CTC while enhancing Illinois' existing EITC will help make the state's tax policy fairer, while also reducing child poverty and providing income support to workers in low-wage jobs. And precisely because that income support is being received by individuals who are far more likely to spend than save it, the private sector economy will receive a boost as well. The reasons for this have everything to do with the multiplier effect associated with enhanced consumer spending.

Nationally, Moody's Analytics found that EITC and CTC programs targeted to low- and middle-income families have a multiplier of $1.27 and $1.25, respectively (the "**Moody's Multipliers**"). This means for every $1 of public sector investment in the EITC, state and local economies should be boosted by an additional $1.27, and for every $1 invested in the CTC, there should be a boost of $1.25 in state and local economies, or a combined boost of $2.52. *For more information regarding multiplier effects, please refer to the full length report.*

As it turns out, the Illinois specific multiplier generated by individuals spending COVID relief benefits of 2.5 (the "**Illinois Specific Multiplier**") is slightly less than the combined national multipliers Moody's Analytics found.[20] Hence for every dollar of such relief received by individuals in Illinois, the private sector received $2.50 in state and local economic benefits.[21] The reasons for this are varied and include everything from Illinois having a higher unemployment rate than the national average, to some of the unique economic impacts created by the pandemic.

In any event, the revenue used to cover the cost of implementing the Tax Equity Initiative in Illinois should be viewed as an investment, since it will generate private sector activity that will exceed the cost of the benefits being funded. In fact, using either the national multipliers identified by Moody's Analytics or the Illinois Specific Multiplier, the annual $415 million dollar cost of funding the Tax Equity Initiative after it is fully phased in, will generate private sector **economic benefits of anywhere from $523 Million to over $1 billion**, or more annually than the cost to taxpayers of funding the legislation.

5. Paying for the Investments Made Under Tax Equity Initiative

5.1. ARPA Funds

In March 2021, the federal government passed the final COVID-19 relief package implemented to date—ARPA. Included in this relief package were Coronavirus State Fiscal Recovery Funds ("**CSFRF**").[22] CSFRF provided financial assistance to state, local and tribal governments. As part of CSFRF, the State of Illinois received $8.127 billion.[23] While some limitations were placed on the use of CSFRF funds, they may be spent on, among other things, providing cash assistance to households that were negatively impacted by the pandemic.[24] That is precisely the type of financial support that would be generated by expanding the state's EITC and creating a state CTC as provided in the Tax Equity Initiative. Hence, Illinois would have the authority use approximately $415 million per year—or just 5 percent of the total CSFRF distributed to Illinois—to expand the EITC and CTC as provided in Tax Equity Initiative.[25]

5.2. Use Greater Than Expected Revenue Growth

After CSFRF funding is no longer available, decision makers could utilize some of the state's natural own-source General Fund revenue growth to cover a portion of the cost of implementing the Tax Equity Initiative. This is especially the case now, as revenue estimates for FY 2022 are greater than initially projected, and hence may indicate the state will have slightly greater natural revenue growth in the future.

The Governor's Office of Management and Budget ("**GOMB**") now estimates that General Fund Revenue in FY 2022 will be $3.3 billion more than initially projected. Hence, after the CSFRF proceeds run-out in FY 2025, a portion of that unanticipated revenue growth—plus any natural increase therein, could be utilized to fund Tax Equity Initiative benefits, at no cost to existing General Fund services.

5.3. Eliminate Ineffective Corporate Tax Expenditures

In FY 2022, the Pritzker Administration and General Assembly closed several ineffective and hence unnecessary business related tax expenditures, which effectively increased General Fund Revenue in Illinois by $655 million annually in nominal dollars. However, some of the corporate tax expenditures the Pritzker Administration initially cited for elimination remain on the books.

If those remaining unnecessary business tax expenditures are in fact eliminated, that will effectively result in the generation of approximately $266 million more in annual, recurring General Fund Revenue. The following are the corporate tax expenditures the Pritzker Administration previously targeted for elimination, but which remain on the books today.

i. Reverse Several Recent Illinois Tax Changes ($179 million)[26]
ii. Cap Retailer's Discount ($73 million)[27]
iii. Limit the Tax Credit For Private Scholarships ($14 million)[28]

Endnotes

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