

# Graduated Rate Income Tax



## GRIT: A Better Way to Tax

### Does Illinois Need a Graduated Rate Income Tax?

The Great Recession ended in June of 2009 but Illinois is still struggling with mounting debt, slow job growth, and a structural deficit. The state's ability to invest in things that grow jobs is curtailed by our ongoing structural deficit.

Illinois' flat tax policy constrains the long-term economic growth in the state's private sector by over taxing our best consumers, low and middle income families. This practice directly reduces consumer spending because over time their income in real inflation adjusted terms has been flat or declining. Since these families do not generally have the ability to save, additional tax dollars they pay comes directly out of what they would otherwise spend in their local economies. This causes problems because the biggest driver of the private sector economy is consumer spending, which now accounts for over 66

percent of all economic activity. Illinois' tax system ranks 3rd highest in tax burden for low income families of all states. The lowest 20% of Illinois earners (under \$18,000) have the largest tax burden (13.7%) with the highest 1% (\$500,000 and up), paying only 5.3%.

The Illinois Constitution requires the income tax to be a flat tax system. Of the 41 states with an individual income tax, all but 7 have a graduated tax rate structure.

The regressive tax system also contributes to the structural deficit because it is not designed to grow to maintain needed services in a modern economy.

To be considered sustainable, a tax system must yield a stream of revenue that grows at the same pace as the services it is intended to fund.

A graduated rate income tax could lower the tax rate of 94% of Illinois' taxpayers who earn under \$150,000 while raising the effective rate on those making over \$150,000 by just 3%.

**A graduated rate income tax would not be a new tax but a new and better revenue system.**

A graduated rate income tax will not hurt the economy but will actually help it. The nine states with the highest graduated income tax rate structures had better growth in the state GDP per capita, better change in median wage, and identical unemployment rates than the 9 states with no income tax.

We know that regressive taxation increases inequalities and progressive taxation reduces inequalities. Focusing taxes on lower income

families, who lose growth in income during inflation over time results in less revenues collected, which then cannot keep up with the economy. Taxation is focused where the economy is contracting instead of where it is expanding. This contributes to the structural deficit of the state because it is not designed to grow in order to maintain needed service levels of a modern economy.

Structural deficits prevent the state from making investments in infrastructure, transit, education and other priorities. Regressive tax policy reduces consumer spending, creating a big problem since two-thirds of all economic activity is consumer spending. A strong economy needs its consumers to spend.



With a regressive tax system, we know there will be major challenges with providing essential services since our revenues have not been growing along with the cost of those services. In fact, there have been many warnings that the State of Illinois is in a precarious financial condition and needs some solid changes very soon.

Comptroller Judy Baar Topinka noted that in the last four years, Illinois' general obligation bonds have been downgraded four times by Fitch, three times by Standard & Poor and four times by Moody's. Most recently, Standard and Poor lowered the rating from A+ to A with a negative outlook giving Illinois the lowest credit score in the nation and costing taxpayers more in interest payments on borrowed funds. The State will soon be paying millions in interest to borrow.

Illinois has been borrowing to pay overdue bills and still has \$9 billion waiting to be paid. They are poised to go out for another \$500 Million soon.

And while the state struggles to pay its bills, those essential services will suffer with the budget process. Education is facing pro-ration of categoricals and \$400 million in General State Aid cuts next year because of increased pension cost pressure on the budget. This would be the third year that education suffers cuts and Illinois already ranks 50th in the nation for funding for our public schools. Even worse, recent projections by the Governor's office indicate that by the year 2015—2016 education spending will drop by more than \$1.4 billion with human services dropping by \$1 billion.

There will continue to be serious cuts in essential services if our

state legislators do not find a solution to the pension crisis. Pension debt payments will overtake every other service in our state if not resolved. Now at some \$97 billion due, each day this is not resolved another \$17 million is added to that total. The Governor's fiscal projections indicate that state taxes and federal assistance will increase in 2014 by \$600 million but pension obligations will increase by \$945 million, wiping out the increase in revenues.

There is not much good news for Illinois' financial future. With all this forecasting, it's clear that Illinois has a revenue problem and its time to consider a new revenue plan.

**The League of Women Voters® of Illinois supports a Graduated Rate income tax system.**



For more information please see:

[www.lwvill.org](http://www.lwvill.org)

or contact:

[Issues@lwvill.org](mailto:Issues@lwvill.org)

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- Under one graduated tax model, a Graduated Rate Income Tax would bring in about \$2.4 billion more in annual state revenue and a reduced tax for 94% of taxpayers.
- Imposing a service tax similar to what our neighboring states have is projected to bring in more than \$3 billion annually.
- **If Illinois can amend its Constitution to allow for a graduated rate income tax, we could:**
  - **Cut overall tax burden for the vast majority of taxpayers**
  - **Raise new revenues and eliminate the structural deficit.**
- **Pay the bills the state owes its vendors**
- **Stimulate growth in jobs**
- **Fund those essential services that citizens consider a priority**
- **Provide a better tax system for all Illinois taxpayers.**

The graduated rate research report, *"The Case for a Graduated Income Tax in Illinois"* may be accessed at the Center for Tax and Budget Accountability website.