Institute on Taxation and Economic Policy
1616 P Street, NW • Washington, DC 20036 • (202) 299-1066

October 19, 2009

A Progressive Strategy for Meeting Illinois' Current and Future Revenue Needs: *Combine the Quinn and Hynes Income Tax Proposals*

Over the course of the past year, Illinois' personal income tax has received a great deal of attention. In March, Governor Pat Quinn put forward a plan to raise the existing income tax rate of 3 percent to 4.5 percent and to increase the value of personal and dependent exemptions from $2,000 to $6,000; the plan, which would, if enacted, generate roughly $3 billion per year, formed the centerpiece of the Governor's efforts to address Illinois' massive budget deficit. More recently, Comptroller Dan Hynes, in announcing his candidacy for Governor, called for the creation of a graduated income tax in Illinois, an approach to taxation that is currently barred by the state constitution and that would require approval by both the Illinois General Assembly and the voters of the state before it became law. In particular, Comptroller Hynes proposed a rate structure that would leave the present 3 percent rate in place for all taxpayers with incomes below $200,000 but that would impose rates ranging from 3.5 percent to 7.5 percent on incomes above that amount, with the highest rate applying solely to income in excess of $1 million. Like Governor Quinn's own income tax plan, Comptroller Hynes' proposal is the focal point of his campaign's tax and budget platform; in fact, his campaign asserts that it will generate some $5.5 billion annually, by far the largest fiscal policy initiative detailed by the Comptroller to date.

While much of the press coverage of these two sets of recommendations has emphasized their differences, the reality is that Illinois policymakers would be wise to adopt both of them. In the short run, given the depth of the state's fiscal woes, the restrictions imposed by its constitution, and the extremely regressive nature of its tax system, the most progressive, most economically sound, and most timely option available to state legislators for generating additional tax revenue is an increase in Illinois' single income tax rate. In the long run, a graduated income tax would be preferable, as it would further enhance tax equity and would put Illinois' tax system on a more sustainable path. The former does not – and should not – preclude the latter, nor, due to the time likely required to enact it, is the latter a complete substitute for the former. Indeed, policymakers should view an increase in the existing single income tax rate as a bridge to a graduated rate structure, a bridge that could be removed once that new structure is in place.

This paper summarizes the income tax plans offered by Governor Quinn and Comptroller Hynes and examines the impact they would have on Illinois taxpayers and on the state's budget. It then outlines a proposal that combines the two to address the fiscal challenges Illinois faces now and into the future.

Summary of the Quinn and Hynes Proposals

Figure 1 below presents the principal differences among current Illinois law as it pertains to the income tax, Governor Quinn's March proposal to modify current law, and Comptroller Hynes' proposal to create a graduated income tax. In general, under current law, Illinois taxpayers determine the amount of income tax they owe by taking the adjusted gross incomes (AGI) they report on their federal tax returns, subtracting $2,000 per personal exemption claimed on their federal returns ($3,000 if blind or elderly), and subtracting another $2,000 per dependent exemption claimed on their federal returns to arrive at the amount of "net income" subject to taxation. They then multiply the amount of net income by the current tax rate of 3.0 percent to determine a preliminary tax liability; lastly, they subtract any credits for which they may be eligible, such as the state's Earned Income Credit or the property tax credit, to find the final amount of income tax they owe.[1]

Figure 1.

KEY FEATURES OF ILLINOIS' INCOME TAX UNDER CURRENT LAW, QUINN & HYNES PROPOSALS

	Current Law	Quinn Proposal	Hynes Proposal
Personal exemption	$2,000 $3,000 if blind or elderly	$6,000 $7,000 if blind or elderly	$2,000 $3,000 if blind or elderly
Dependent exemption	$2,000	$6,000	$2,000
Income tax rate(s)	3.0% on all net income	4.5% on all net income	3.0% on net income (NI) up to $200,000; 3.5% on NI between $200,000 and $300,000; 5.5% on NI between $300,000 and $500,000; 7.0% on NI between $500,000 and $1 million; 7.5% on NI over $1 million
Credit(s)	Property tax credit, Earned Income Credit, et. al.	Same as current law	Same as current law
Effective date	---	July 1, 2009*	January 1, 2011

** The Quinn proposal was initially put forward in March 2009*

Governor Quinn would alter these calculations by increasing the value of the personal and dependent exemptions to $6,000 each and by raising the income tax rate from 3.0 percent to 4.5 percent.[2] Consequently, some low-income taxpayers – and, in particular, low-income families with children – would actually see their income taxes decline under the Quinn

[1] This description of current law simplifies the calculations for determining one's income tax liability somewhat. For instance, Illinois filers also make adjustments, such as adding federally-exempt interest income or subtracting federally-taxable Social Security benefits, to their federal adjusted gross income. In addition, non-residents follow a slightly different process for determining the amount of income subject to tax in Illinois.

[2] These two changes constitute the original version of the Governor's income tax plan, as outlined in his March 18, 2009 budget address (summarized at http://www.state.il.us/budget/Press%20Releases/03.18.09%20FY%2010%20budget%20press%20release.pdf). While, in the intervening seven months, the Governor has suggested modifications to this proposal and has expressed support for other, similar income tax proposals debated in the Legislature, this proposal appears to be the focus of the respective gubernatorial campaigns and, as such, is the basis for the analysis presented here.

proposal, while most other taxpayers would witness a tax increase. Both of these outcomes will be discussed in more detail below, but it is important to note that, given the restraints currently imposed by the Illinois Constitution, it is exceptionally difficult to structure an increase in the income tax in such a way that it avoids raising taxes for the majority of Illinoisans.[3] Yet, even with those restraints in place, an increase in the income tax remains among the fairest options available to Illinois policymakers for generating additional revenue: fairer than higher excise taxes, fairer than a higher sales tax rate, and fairer than a broader sales tax base.

Comptroller Hynes would modify these calculations by substituting a set of graduated rates (as specified in Figure 1) for Illinois' current single income tax rate of 3.0 percent. Since the Comptroller would make no other changes to Illinois' income tax and would leave in place the current single rate for net incomes below $200,000, any Illinoisan with net income (for tax purposes) below that amount would neither receive a tax cut nor experience a tax increase. Still, where the Quinn proposal would only need to be approved by the General Assembly to become law, the Hynes proposal would have to travel a more tortuous path: an amendment to the Illinois Constitution permitting a graduated income tax would first have to be referred to the voters by an act of the Assembly, that amendment would have to approved by a majority of Illinois voters, and, finally, the Assembly would have to enact a statute putting the specifics of the new income tax structure into law. This is not to suggest that Illinois policymakers and the public should not undertake such a journey; rather, they should simply be mindful that any fundamental reform of Illinois' tax system – no matter how vital – may take longer than anticipated.

Impact of the Quinn and Hynes Proposals

Figure 2 below details the impact that the Quinn and Hynes proposals would have on Illinois residents at different income levels, the amount of revenue that each proposal would generate, and the proportion of the overall tax change that would be "offset" by lower federal income taxes.[4]

As Figure 2 confirms, the Hynes proposal would constitute a more targeted approach to generating additional revenue. If the Hynes proposal became law, it would mean higher taxes for just 3 percent of Illinois taxpayers; in fact, nearly all – 95 percent – of the additional tax revenue yielded by the Hynes proposal would be paid by the richest 1 percent of Illinois taxpayers, taxpayers whose average income is expected to exceed $1.5 million in 2011. In comparison, the Quinn proposal would lead to higher income taxes for 58 percent of Illinoisans, with the bulk of the increase percent paid by the richest 20 percent of Illinoisans, that is, families and individuals with projected incomes of more than $94,600 in 2011.

---

[3] Article IX, § 3 of the Illinois Constitution, as ratified in 1970, stipulates that "A tax measured on or measured by income shall be at a non-graduated rate." However, Article IX, § 2 does allow for reasonable exemptions, deductions, and credits.

[4] The results presented in Figure 2 were generated by the ITEP Microsimulation Model; for more on the model and the methodology used to generate these results, see http://www.itepnet.org/itepmodel.htm. These results assume that both the Quinn proposal and the Hynes proposal are fully in effect in tax year 2011.

Figure 2.

IMPACT OF QUINN AND HYNES INCOME TAX PROPOSALS
All Illinoisans, 2011 income levels

			Quinn Proposal		Hynes Proposal	
Income Group	Income Range	Average Income in Group	Tax Change as a Share of Income	Average Tax Change	Tax Change as a Share of Income	Average Tax Change
Lowest 20%	Less than $19,300	$ 11,100	–0.4%	($47)	—	$0
Second 20%	$19,300 to $37,800	$ 28,100	0.0%	$5	—	$0
Middle 20%	$37,800 to $59,800	$ 48,400	0.4%	$178	—	$0
Fourth 20%	$59,800 to $94,600	$ 75,400	0.5%	$383	—	$0
Next 15%	$94,600 to $192,000	$ 128,000	0.7%	$954	—	$0
Next 4%	$192,000 to $462,700	$ 286,800	1.0%	$2,752	0.2%	$458
Top 1%	$462,700 and over	$ 1,537,400	1.1%	$16,791	2.3%	$35,926

	Quinn Proposal	Hynes Proposal
Share of Illinois taxpayers with tax increase	58%	3%
Share of Illinois taxpayers with tax cut	27%	—
Share of Illinois taxpayers unaffected	15%	97%
State tax change ($M)	$3,080	$2,216
Federal tax change ($M)	($655)	($850)
Net state & federal tax change ($M)	$2,425	$1,366

Still, the data included in Figures 2 and 3 demonstrate quite clearly that the Quinn proposal neither would "[raise] income taxes by 50 percent on all Illinois families" nor would it be "harshly regressive."[5] Overall, 27 percent of Illinois taxpayers – principally those at the bottom of the income distribution – would enjoy a tax cut if the Quinn proposal made its way into law; indeed, as Figure 3 suggests, any family of four whose "Illinois base income" is below $56,000 in 2011 would see its taxes fall.[6] Another 15 percent of Illinoisans would be unaffected by the Quinn proposal, largely because their incomes are already too low to owe any income tax (though they do continue to pay sales, excise, and other taxes). For those Illinois taxpayers who would incur a tax increase if the Quinn proposal became law, in no instance would the increase amount to 50 percent, due to the exemption increases the

---

[5] *Hynes Formally Announces Candidacy by Outlining a Comprehensive Path Forward on State Budget Crisis*, September 2, 2009, downloaded from http://www.danhynes.com/node/47 and *Announcement of Hynes Plan and Discussion of Candidacy (Remarks Prepared for Delivery),* September 2, 2009, downloaded from http://www.danhynes.com/dan-hynes-remarks-on-campaign-kickoff.

[6] "Illinois base income" is a taxpayer's federal adjusted gross income (AGI) after accounting for any Illinois-specific adjustments, such as subtracting out federally-taxable Social Security benefits or other retirement income; it is the amount of income from which Illinois taxpayers subtract the exemptions to which they are entitled to determine net income.

proposal would entail; as Figure 3 illustrates, the tax increase would often be substantially less than 50 percent. Furthermore, most tax analysts would agree that any change in law that results in uniformly larger tax increases (relative to income) for affluent taxpayers than for low- and moderate-income taxpayers should be described as "progressive." As Figure 2 shows, that is precisely the outcome of the Quinn proposal: in the aggregate, taxpayers comprising the middle 20 percent of the income distribution in Illinois would face a tax increase equal to 0.4 percent of their incomes on average, yet taxpayers in the 81st to 95th percentile would see a tax increase equivalent to 0.7 percent of their collective incomes. Taxpayers in the top 1 percent would pay 1.1 percent of their incomes in additional taxes. In other words, rather than perpetuate Illinois' regressive tax system, the Quinn proposal represents a meaningful step towards greater tax fairness.

Figure 3.

IMPACT OF THE QUINN PROPOSAL ON TWO MIDDLE-INCOME FAMILIES

	Family 1	Family 2
Current IL Law		
IL base income	$ 50,000	$ 75,000
Personal exemptions	4,000	4,000
Dependent exemptions	4,000	4,000
IL net income	42,000	67,000
Initial tax owed @ 3% rate	1,260	2,010
Property tax credit	130	175
Final tax owed	1,130	1,835
Quinn Proposal		
IL base income	$ 50,000	$ 75,000
Personal exemptions	12,000	12,000
Dependent exemptions	12,000	12,000
IL net income	26,000	51,000
Initial tax owed @ 4.5% rate	1,170	2,295
Property tax credit	130	175
Final tax owed	1,040	2,120
Change in tax owed ($)	**$ –90**	**$ 285**
Change in tax owed (%)	**–8.0%**	**15.5%**

Income is assumed to consist solely of salaries and wages; families are assumed to be married couples with two children

The Quinn and Hynes proposals would also have different consequences for Illinois' fiscal outlook, as they would generate substantially different amounts of revenue. If the Quinn plan were fully implemented in 2011, it could be expected to generate approximately $3.1 billion in additional tax revenue. In contrast, if the Hynes proposal were in full effect that year, it is projected to yield a notably smaller amount of roughly $2.2 billion.[7]

[7] ITEP's projection of the amount of revenue that the Hynes proposal would generate in 2011 is significantly lower than the amount anticipated by the Hynes campaign. Campaign materials downloaded from www.friendsofdanhynes.com on September 8, 2009 and entitled *Leading Illinois Forward: The Hynes Plan for Tax Fairness & Fiscal Responsibility* claim that the graduated income tax plan put forward by Comptroller Hynes would produce $5.5 billion on an annual basis. ITEP has been unable to establish the basis for such a claim.
The principal factors in determining the amount of revenue future income tax changes would generate are the rates of growth for different forms of income such as salaries and wages, dividend and interest income, and capital gains, which taken together comprise nearly 90 percent of adjusted gross income in Illinois. ITEP projects

One other factor to consider in comparing income tax proposals is the effect they would have on Illinoisans' federal income tax bills. Federal income taxpayers who choose to itemize their deductions, rather than utilizing the standard deduction, can subtract the state and local income taxes they pay in calculating the amount of their incomes subject to taxation. Consequently, as state and local income taxes rise, the amount of income subject to the federal income tax falls – and with it, the amount of federal income taxes owed. This interaction is commonly referred to as the "federal offset" and can oftentimes be quite substantial. In the case of the Quinn proposal, Illinoisans, in the aggregate, would see their federal income tax liability fall by approximately $655 million in 2011.[8] Thus, while the state of Illinois would collect an additional $3.1 billion if the Quinn proposal were to become law, the net state and federal income taxes paid by Illinoisans would rise by only $2.4 billion. The "federal offset" would be even more pronounced under the Hynes proposal, since it focuses almost exclusively on the affluent, a group of taxpayers that is far more likely to take advantage of itemized deductions on its federal returns. Specifically, the Hynes proposal, if enacted, would reduce the federal income taxes paid by Illinoisans by $850 million in 2011; put another way, nearly two-fifths of the state tax increase resulting from the Hynes proposal would be paid for by the federal government.

Combining the Quinn and Hynes proposals

To ease comparisons, the preceding analysis examines both the Quinn proposal and the Hynes proposal as if they were fully in effect in 2011. Yet, the perilous state of Illinois finances requires a major infusion of revenue well before that date.[9]

According to a recent reports from Voices for Illinois Children and its Budget & Tax Policy Initiative (BTPI), the budget approved by Governor Quinn and the General Assembly for the current fiscal year relies on $3.4 billion worth of borrowing to bring revenue into line with expenditures, even after reducing spending on early childhood, mental health and other programs by more than $1 billion; worse still, the BTPI projects that Illinois' revenues are likely to be $11.7 billion short of the amount needed to maintain even these reduced service levels in fiscal year 2011.[10,11] Of course, both the amount of debt issued to balance the current budget and the size of future budget deficits would be significantly smaller had the General

---

that these three sources of income will grow, in the aggregate, by roughly 4 percent in nominal terms between 2009 and 2011 in Illinois; its tax revenue projections are, in turn, based on these growth rates.

[8] The estimates of the federal "offset" presented in this paper assume, as scheduled under law, the full expiration in 2011 of the federal tax cuts enacted in 2001 and 2003.

[9] Comptroller Hynes has called for additional changes in tax policy, such as broadening Illinois' sales tax base and repealing the so-called "single sales factor" tax break currently enjoyed by large corporations doing business in Illinois, that would help generate revenue in fiscal year 2010. However, according to the Hynes campaign, these changes would generate just $425 million in FY10, thus necessitating large cuts in spending and the issuance of additional debt to close any remaining budget gap.

[10] *Budget bulletin,* Voices for Illinois Children, available at http://www.voices4kids.org/getinvolved/files/Budget%20Bulletin%20recap%202.pdf

[11] *Without new revenues, Illinois' budget shortfall will grow to more than $11.7 billion next year*, Illinois Budget & Tax Policy Initiative, September 9, 2009, available at http://www.voices4kids.org/getinvolved/files/FY11deficit090909.pdf

Assembly approved the proposal put forward by Governor Quinn – or other, alternative income tax plans – as it would have taken effect in July of this year.

Moreover, while Comptroller Hynes expects that the Assembly could prepare a constitutional amendment permitting a graduated income tax for public approval, that the voters of Illinois could enact such an amendment, and that the Assembly could subsequently adopt legislation stipulating the specific form a graduated income tax would take, all in time for additional revenues to be collected for the whole of 2011, such a timeline may be unduly optimistic.

Consequently, Illinois policymakers would be well served in following a revenue-raising strategy that has both a short-run and a long-run component, that is, a strategy that generates a substantial sum of revenue in a very timely fashion, but that ultimately improves the incidence of that particular revenue stream from a tax fairness perspective.

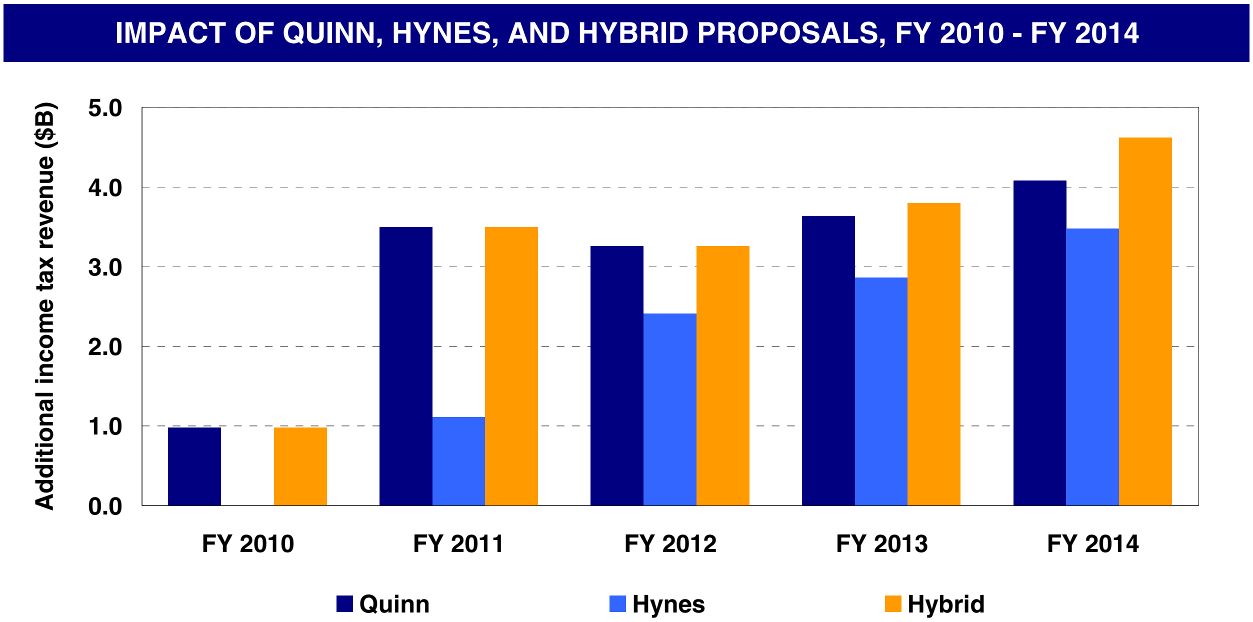
Figure 4.

KEY FEATURES OF ILLINOIS' INCOME TAX UNDER CURRENT LAW, HYBRID PROPOSAL

		Hybrid Proposal					
	Current Law	*TY 2010*	*TY 2011*	*TY 2012 and thereafter*			
Personal exemption	$2,000 $3,000 if blind or elderly	$6,000 $7,000 if blind or elderly	$6,000 $7,000 if blind or elderly	$6,000 $7,000 if blind or elderly			
Dependent exemption	$2,000	$6,000	$6,000	$6,000			
Income tax rate(s)	3.0% on all net income	4.5% on all net income	4.5% on all net income	Range of Net Income			Rate
				Married Filing Joint Returns	*Head of Household Filers*	*Single Filers*	
				$ —	$ —	$ —	3.0%
				$ 50,000	$ 37,500	$ 25,000	4.5%
				$ 100,000	$ 75,000	$ 50,000	5.0%
				$ 300,000	$ 225,000	$ 150,000	5.5%
				$ 500,000	$ 375,000	$ 250,000	7.0%
				$ 1,000,000	$ 750,000	$ 500,000	7.5%
Credit(s)	Property tax credit, Earned Income Credit, et. al.	Same as current law	Same as current law	Same as current law			

That strategy could be devised by combining the principal elements of the Quinn and Hynes income tax proposals. For instance, as outlined in Figure 4, Illinois policymakers, could enact, for tax year 2010, the two elements of the Quinn proposal – an increase in personal and dependent exemptions to $6,000 and an increase in the single income tax rate to 4.5 percent – and then leave those changes in place until such time as a constitutional amendment permitting a graduated income tax has been approved by the voters. (Figure 4 assumes that this occurs in time for such changes to take effect in tax year 2012, but earlier or later approval is of course possible.) Once such an amendment has been approved, the stream of revenue yielded by the elements of the Quinn proposal could be replaced, albeit in a more progressive manner, by the changes specified in Figure 4, which are fashioned after, but do not precisely replicate, the Hynes proposal.

Figure 5.



Such a strategy has at least two merits. First, as Figure 5 highlights, it would produce a more timely, more sizable, and more certain revenue source than the current version of the Hynes proposal. Like the Quinn proposal, the hybrid proposal described here could be acted upon by the General Assembly in relatively short order, thus providing an infusion of revenue when it is most needed; once in place, it could be sustained if any delays in approving a constitutional amendment are encountered. More specifically, the short-run elements of the Quinn and hybrid proposals, if put in effect in tax year 2010, could be expected to produce about $1 billion in additional revenue in fiscal year (FY) 2010, roughly $3.5 billion in FY 2011, and around $3.25 billion in FY 2012. If the Illinois Constitution were then successfully amended so as to allow a graduated income tax, the hybrid plan would then yield approximately $3.8 billion in FY 2013 and larger amounts thereafter; if the efforts to amend the Constitution were delayed or unsuccessful, keeping the short-run elements of the hybrid plan in place would continue to generate $3.6 billion over and above current law in FY 2013. In contrast, in no year between FY 2010 and FY 2014 could the Hynes plan be counted upon for more than $3.5 billion in additional revenue; of note, even if enacted in the time frame envisioned by the Hynes campaign, it would take until FY 2014 for the Hynes proposal to generate more than $3 billion in new revenue, a threshold that the Quinn proposal could cross as early as FY 2011.

Figure 6.

IMPACT OF HYBRID INCOME TAX PROPOSAL
All Illinoisans, 2011 income levels

Income Group	Income Range	Average Income in Group	Tax Change as a Share of Income	Average Tax Change
Lowest 20%	Less than $19,300	$ 11,100	–0.7%	($81)
Second 20%	$19,300 to $37,800	$ 28,100	–0.6%	($166)
Middle 20%	$37,800 to $59,800	$ 48,400	–0.3%	($129)
Fourth 20%	$59,800 to $94,600	$ 75,400	–0.1%	($60)
Next 15%	$94,600 to $192,000	$ 128,000	0.3%	$387
Next 4%	$192,000 to $462,700	$ 286,800	1.0%	$2,799
Top 1%	$462,700 and over	$ 1,537,400	2.6%	$40,586

Share of Illinois taxpayers with tax increase	26%
Share of Illinois taxpayers with tax cut	59%
Share of Illinois taxpayers unaffected	15%
State tax change ($M)	$2,868
Federal tax change ($M)	($1,086)
Net state & federal tax change ($M)	$1,782

Second, as Figure 6 indicates, combining elements of the Quinn and Hynes proposals could yield an outcome that is more progressive than either of them individually. If such a hybrid proposal were in place in 2011, nearly 60 percent of Illinoisans (due to the maintenance of larger personal and dependent exemptions) would receive a tax cut, with those individuals and families comprising the bottom 40 percent of the income distribution seeing a cut of 0.6 to 0.7 percent of income on average. Conversely, about a quarter of Illinoisans would incur a tax increase, with the richest one percent of taxpayers facing an increase tantamount to 2.6 percent of income.

Conclusion

Governor Pat Quinn and Comptroller Dan Hynes have each offered progressive proposals to increase the amount of revenue Illinois collects through its income tax. While some may view them as competing proposals, the reality is that they are complementary, due to the general fiscal difficulties now plaguing most states and to the particular features of the Illinois Constitution.

Illinois, like virtually every other state in the union, is in the midst of a serious fiscal crisis; indeed, independent analysts such as the Center on Budget and Policy Priorities and the Center for Tax and Budget Accountability expect that the state will have to close a budget gap totaling some $13 to $15 billion over the next twenty-one months.[12] Consequently, if Illinois is to avoid severe cuts to the public services that working people count on every day, it will require a substantial infusion of revenue in the very short term. Governor Quinn's proposal responds to these pressing demands, as it could generate close to $1 billion for use in fiscal year 2010 and approximately $3 billion on an annual basis.[13]

Illinois, unlike most states, is constitutionally barred from imposing a graduated income tax; as a result, Illinois' tax system, as a whole, is among the most regressive in the nation, as the single rate income tax is unable to balance out the unfair incidence of sales, excise, and property taxes. Comptroller Hynes' proposal responds to this long-standing flaw, as it would ultimately permit the state to impose higher tax rates on more affluent residents and, thus, to generate additional tax revenue in the years ahead without placing greater responsibilities on families struggling to make ends meet.

In short, both proposals are necessary if Illinois is to meet the challenges it faces now and into the future. Illinois legislators seeking to preserve essential public services while promoting greater tax fairness would do well to combine them into a single, two-stage strategy.

---

[12] McNichol, Elizabeth and Lav, Iris J., *New Fiscal Year Brings No Relief from Unprecedented State Budget Problems*, Center on Budget and Policy Priorities, Washington, DC, September 3, 2009 and *Fact Sheet: Illinois State Deficit Problems,* Center on Tax and Budget Accountability, Chicago, IL, August 26, 2009.

[13] Other approaches to generating additional revenue in the short term are, of course, possible. HB 174, which was approved by the Illinois Senate in May 2009, but which foundered in the House of Representatives, would have, by some estimates, yielded in excess of $5 billion annually; it would have raised both the personal income tax rate and the corporate income tax rate to 5 percent, increased exemptions to $3,000 each, enhanced the property tax credit and the Earned Income Tax Credit, and expanded the state's sales tax based to include certain services.