



# BUDGET & TAX POLICY INITIATIVE

## ISSUE BRIEF

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## IMPROVE TAX FAIRNESS FOR LOW-INCOME WORKING FAMILIES

### TESTIMONY SUBMITTED TO THE HOUSE REVENUE AND FINANCE COMMITTEE

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Voices for Illinois Children does not support Senate Bill 397, House Committee Amendment No. 2, most of which involves tax subsidies for business. We do, however, strongly support an important provision of the bill that would improve tax fairness for low-income working families. The Illinois earned income tax credit (EITC) — established in 2000 and made permanent and strengthened in 2003 — is set at only 5 percent of the federal EITC. SB397 would expand the state EITC to 10 percent of the federal credit in tax year 2012 and to 15 percent of the federal credit in tax year 2013.

#### **Earned Income Tax Credit: Federal and State Policies**

The federal EITC is a targeted tax credit for low-income working households. The primary beneficiaries are families with children. The EITC is structured to encourage and reward work by allowing families to keep more of what they earn. For families well below poverty level, the dollar amount of the credit increases with higher earnings. Households are eligible for the maximum credit as their earnings approach the poverty line. The credit then gradually phases out at higher income levels. Research shows that the federal EITC is one of the nation's most effective anti-poverty tools, especially for children. In 2010, the EITC moved an estimated 5.4 million people, including 3 million children, above the poverty level.<sup>1</sup>

More than 20 states have built on the success of the federal EITC by adopting their own targeted tax credits. In most cases, these state EITCs are set as a percentage of the federal credit. A majority of state EITCs are at least 15 percent of the federal EITC. Examples include Massachusetts (15%), Kansas (18%), Virginia (20%), Rhode Island (25%), and Vermont (32%). Illinois is one of only four states with an EITC as low as 5 percent of the federal credit.<sup>2</sup>

#### **State Income Taxes and Low-Income Families**

Among the 42 states that have income taxes, most use some combination of standard deductions, personal exemptions, and targeted tax credits to reduce the tax liabilities of low-income households. The Illinois income tax has no standard exemption and a small personal exemption (\$2,000 per household member), as well as a small EITC. Consequently, even before the income tax

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<sup>1</sup> Robert Greenstein, "Government Programs Kept Millions Out of Poverty in 2010" (Center on Budget and Policy Priorities, September 2011).

<sup>2</sup> Nicholas Johnson and Erica Williams, "A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty in 2011" (Center on Budget and Policy Priorities, April 2011).

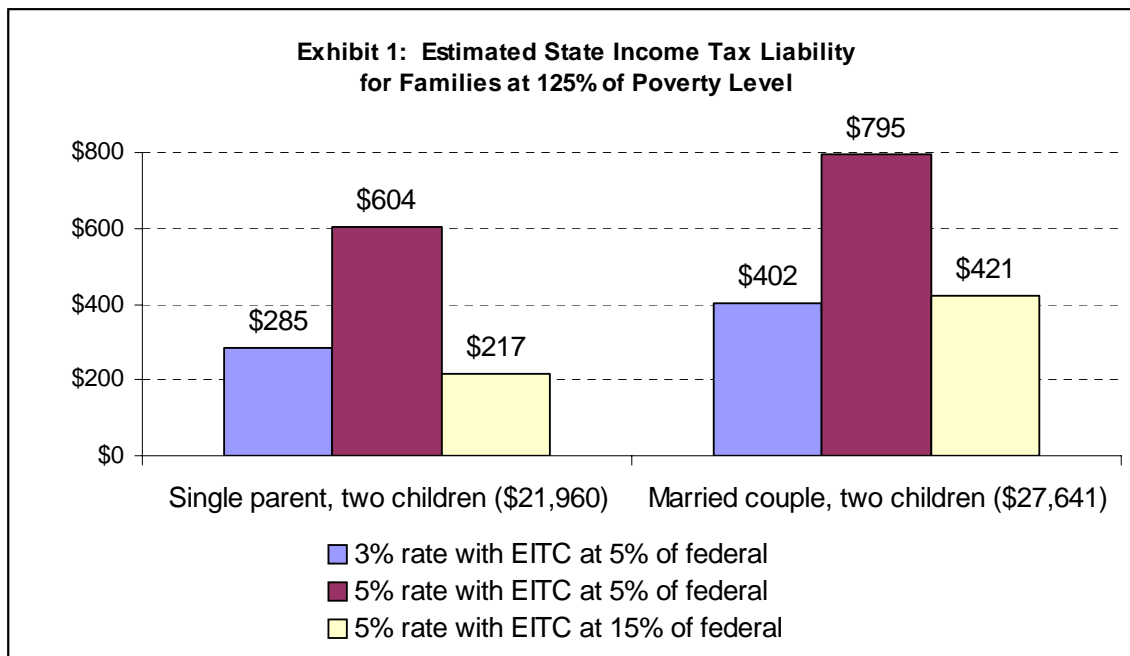
increase enacted last January, liabilities for low-income families in Illinois were among the highest in the nation. In 2010, only five states imposed higher taxes on a single-parent family of three at the federal poverty level, which was about \$17,500. For a two-parent family of four at poverty level (about \$22,000), only six states had higher taxes than Illinois.<sup>3</sup>

The income tax increase was an essential step toward resolving the state’s prolonged fiscal crisis. The new revenue — together with significant spending cuts — has substantially reduced the cumulative budget deficit.<sup>4</sup> However, the revenue legislation included no provisions to improve tax fairness. As a result, *low-income families were disproportionately affected by the higher tax rate*. Income tax liabilities more than tripled for single parents with two children at poverty level and jumped by more than 150 percent for comparable married couples with two children.

**Effects of Expanding the State EITC**

*The regressive impact of the income tax increase on families with children could be significantly mitigated by expanding the state EITC.* Consider the case of a single mother with two children at 125 percent of the federal poverty level. Her income (about \$22,000) would be just below the median for all single-mother families in Illinois (about \$24,000). When the state income tax rose from 3 percent to 5 percent, the tax liability for this single mother jumped from \$285 to \$604. However, tripling the EITC would reduce her taxes to \$217, more than offsetting the rate increase (see Exhibits 1 and 2).

For a married couple with two children at 125 percent of poverty level, household income would be about \$27,600. This family’s state income tax liability rose from \$402 in 2010 to \$795 in 2011. If the EITC were tripled, their taxes would be only \$421 — a 47 percent tax cut that would offset nearly all of the rate increase (see Exhibits 1 and 2).



<sup>3</sup> See Phil Oliff and Nicholas Johnson, “The Impact of State Income Taxes on Low-Income Families in 2010” (Center on Budget and Policy Priorities, November 2011).

<sup>4</sup> See “Update on the Impact of New Income Tax Revenue” (Budget & Tax Policy Initiative, Voices for Illinois Children, October 2011).

**Exhibit 2: Calculation of State Income Tax Liability for Families at 125% of Poverty Level**

	Single parent with two children	Married couple with two children
Earned income	\$21,960	\$27,641
Exemptions	-6,000	-8,000
Taxable income	15,960	19,641
Tax rate at 3%	479	589
State EITC at 5% of federal	-194	-187
Tax liability	285	402
Tax rate at 5%	798	982
State EITC at 5% of federal	-194	-187
Tax liability	604	795
Tax rate at 5%	798	982
State EITC at 15% of federal	-581	-561
Tax liability	217	421

Note: Poverty thresholds and EITC are at 2010 levels.

**Conclusion**

Voices for Illinois Children cannot endorse a tax package that would result in a significant net loss of state revenue. The General Assembly should not approve any legislation that would increase the cumulative deficit, exacerbate the problem of delays payments to providers, or require additional cuts in spending for education, health care and human services.

We could, however, support fiscally responsible legislation that included expanding the state EITC to 15 percent of the federal credit. *Increasing the EITC would alleviate economic hardship for more than 900,000 families with children.* Moreover, by cutting taxes for low-income families and stimulating consumer spending, a stronger EITC would have positive effects on local economies.<sup>5</sup> Now is the time to enhance tax fairness for low-income working families in Illinois.

**About the Budget & Tax Policy Initiative**

The Budget & Tax Policy Initiative (BTPI) at Voices for Illinois Children provides timely, credible, and accessible information and analysis on fiscal issues that affect children, families, and communities in Illinois. BTPI is a member of the State Fiscal Analysis Initiative (SFAI), a network of nonprofit organizations in more than 35 states. SFAI is coordinated by the Center on Budget and Policy Priorities, a Washington, D.C.-based research organization and strategic policy institute that works on a range of federal and state issues.

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<sup>5</sup> See Alan Berube, "Using the Earned Income Tax Credit to Simulate Local Economies" (Living Cities Policy Series, November 2006).