



Recent Changes in the State Earned Income Tax Credit and the Personal Exemption Help to Improve the Lives of Working Families in Illinois

What is the EITC? The federal Earned Income Tax Credit (“EITC”) is a refundable income tax credit for low- and moderate-income workers. The credit reduces the amount of tax an individual owes, and if the credit is larger than their income tax liability, they get a refund for the difference. The federal EITC was established in 1975 and today is claimed by roughly one out of every seven families who file a federal tax return. Former President Ronald Reagan described the federal EITC as the best pro-family, pro-job, anti-poverty legislation Congress ever passed.

Recognizing the immense benefit provided by the federal EITC, in May of 2000, Illinois established a non-refundable state EITC. By tax year 2001, over 584,000 low-income, working families received this critical work support, putting an additional \$44 million in their pockets. This year as the original law was set to expire, the Illinois General Assembly voted both to reauthorize the state EITC, making it permanent, and to improve the credit by making it refundable.

“Refundable” simply means that if the credit exceeds the income tax liability of a low-income working family, they receive a refund for the difference. This refund is not a giveaway. It recognizes that the real tax burden for most low- and moderate-income workers comes from sales, property, excise and payroll taxes, not income taxes. By reducing real tax burden, it rewards the lowest-income working families, who don’t earn enough to owe income taxes, for getting jobs. Now that the state EITC is refundable, its benefits will reach an additional 150,000 to 200,000 of the lowest-income working families in Illinois.

What is the Personal Exemption?

The personal exemption is the amount excluded from gross income when calculating taxable income. Illinois tax law allows a full exemption for each family member – head of household plus dependents. After having remained at \$1000 since the inception of the Illinois income tax in 1969, the personal exemption was doubled to \$2000 over a 3-year period in the late 1990s.

How do the EITC and Personal Exemption Work Together to Benefit Working Families?

Illinois has one of the most regressive tax systems in the country – the system imposes a greater tax burden on low- and moderate-income families than affluent families, when tax burden is measured as a percentage of annual income. The state Earned Income Tax Credit and the personal exemption together have had a significant, positive impact on working families, because they have helped off-set the regressive nature of the Illinois tax system and greatly reduced the income tax liability for hard-working families.

Example 1: A single parent with two children earning minimum wage (\$10,700 annually). Without the personal exemption or EITC, this family would owe **\$321** in Illinois income taxes. However, by reducing gross income by the value of the personal exemption $\{ \$10,700 - (\$2,000 \times 3) = \$4,700 \}$, the family’s income tax liability is reduced to **\$141**. Finally, by claiming the

state EITC (Illinois EITC: 5% of federal EITC of \$4,140 = \$207), their income tax liability is eliminated, and this family receives a tax refund of \$66.

Example 2: A two-parent family of four, earning \$18,500 annually. Without the personal exemption or EITC, this family would owe \$555 in Illinois income taxes. However, by reducing gross income by the value of the personal exemption { $\$18,500 - (\$2,000 \times 4) = \$10,500$ } the family’s income tax liability is reduced to \$315. Finally, by claiming the state EITC (Illinois EITC: 5% of federal EITC of \$3,297 = \$165) this family’s income tax liability is reduced to \$150.

Example 3: A single parent with three children, earning \$24,000 annually. Without the personal exemption or EITC, this family would owe \$720 in Illinois income taxes. However, by reducing gross income by the value of the personal exemption { $\$24,000 - (\$2,000 \times 4) = \$16,000$ } the family’s income tax liability is reduced to \$480. Finally, by claiming the state EITC (Illinois EITC: 5% of federal EITC of \$1,928 = \$96) this family’s income tax liability is reduced to \$384.

The positive effect of the state EITC and personal exemption on working families in Illinois

Income Level	Family Composition	Taxes owed to IL w/out EITC or PE	Taxes owed to IL w/ PE	Taxes owed to IL w/ PE & IL EITC	Family Savings due to PE & IL EITC
\$10,700	Single Parent 2 Children	\$321	\$141	\$66 Refund	\$387
\$18,500	Two Parents 2 Children	\$555	\$315	\$150	\$405
\$24,000	Single Parent 3 Children	\$720	\$480	\$384	\$336

How can the state EITC and the Personal Exemption be improved? As the examples illustrate, the state EITC and personal exemption have served as valuable tools for reducing poverty in Illinois. However, they can be improved to make an even greater difference in the lives of Illinois’ poorest working families.

- **Improving the state EITC:** While the improvements made to the state EITC this year make a significant difference for working families, further improvement is still possible. Increasing the credit to 20% of the federal EITC from its current level of 5% would allow greater offset of income tax burden imposed on the poorest working families.
- **Improving the Personal Exemption:** The original personal exemption of \$1,000 is worth roughly \$4,700 in today’s dollars. Because the exemption is not adjusted for inflation, the current personal exemption of \$2,000 is worth less than half the real value of the exemption enacted in 1969. This, in turn, exacerbates the tax burden on low-income working families.

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