Policies, Politics and REMI: The case of an Income Tax Increase.

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Disclaimer:

• The contents and opinions expressed in this presentation are my own and do not represent a statement of policy on behalf of the Governor of Illinois.

IL Individual Income Tax (IIT) brief history:

- August 1, 1969: Individual Income tax is introduced in Illinois at a rate of 2.5%.
- FY84: Transitory increase of tax rate from 2.5% to 3% (July 1, 1983 to June 30, 1984)
- FY90 on: Permanent increase in tax rate to 3% (In place July 1, 1989)
- FY11 IIT tax rate was increased to 5% (January 1, 2011)
- FY15 IIT rate decreased to 3.75% (January 1, 2015)
- FY18 IIT rate increased to 4.95% (July 1, 2017)

IL House Bill 3522: Proposed to amend the Illinois Individual Income Tax Act, effective January 1, 2018:

• (1) 4% of the portion of the taxpayer's net income from \$0 to \$7,500;

• (2) 5.84% of the portion of the taxpayer's net income exceeding \$7,500 but not exceeding \$15,000;

• (3) 6.27% of the portion of the taxpayer's net income exceeding \$15,000 but not exceeding \$225,000;

• (4) 7.65% of the portion of the taxpayer's net income exceeding \$225,000.

Methodology:

- Step 1: Determine revenue impact using microsimulation model (static analysis).
- Step 2: Do fiscal and Economic impact using dynamic analysis via REMI.

Illinois micro-simulation model:



Static revenue estimate via micro-simulation using more than 6 million data records.



INPUT VARIABLES:

- Primary SSN
- Spouse SSN
- Address
- City
- County
- State
- Zip Code
- Filing Status
- Federal Adjusted Gross Income
- Federal Tax-Exempt Income
- Other Income Additions
- Social Security Benefits
- IL Income Tax Overpayment
- Other Income Subtractions
- Number Of Exemptions From Fed. Form.
- Number Of Exemptions

- Exemption Prime 65+
- Exemption Spouse 65+
- Exemption Prime Blind
- Exemption Spouse Blind
- Exemption Allowance
- Residents Net Income
- Resident Indicator
- Non-Resident Net Income
- Tax Amount
- Recapture Of Investment Credit
- Income Tax Paid To Other State
- IL Property Tax Credit Base
- IL Property Index Number
- IL Business Expense
- IL Property Tax Credit
- Education Expense Credit Base
- Education Expense Credit
- Income TaxCredit1299C
- Use Tax

- IL Income Tax Withheld
- Estimated Payments
- Pass Through Credits
- Earned Income Credit Base
- Earned Income Credit
- Over Payment
- Tax Due
- Late ES Penalty
- Farming
- Nursing Home
- Annualized Income
- Donations Total
- Over Payment After Penalty And Donations.
- Refund Amount
- Direct Deposit Indicator
- Credit Carry Forward
- Amount Owed

Simulate IL-1040 return calculation

- Federal Income tax starting point
 - Minus state subtractions, for example federally taxed retirement and SS income.
 - Plus: state additions, such as federally tax-exempt interest income.
 - Minus state allowed exemptions:
 - Personal exemption.
 - Legally blind exemption.
 - 65 or over exemption.
- = Net Income
 - Times the tax rate = Tax liability before credits
 - Minus:
 - Income tax credits such as: taxes paid to other states, property tax credit, education expense credit and earned income tax credit.
 - Plus:
 - Late payment penalty, voluntary donations
- = Net Tax Liability

STATIC REVENUE IMPACT:

(\$millions)	2019	2020	2021	2022	2023
Additional IIT revenue	\$5,299	\$5,442	\$5,589	\$5,740	\$5,895
Decrease in sales tax revenue	(\$917)	(\$944)	(\$973)	(\$1,002)	(\$1,032)
Total net new revenue	\$4,382	\$4,498	\$4,617	\$4,738	\$4,863

Dynamic analysis - Three scenarios were analyzed:

• <u>Scenario 1:</u> All net new revenue is used to pay debt.

• <u>Scenario 2:</u> Half of the net new revenue is used to pay debt, while the other half is used to increase current state government spending.

• <u>Scenario 3:</u> All net new revenue is used to increase current state government spending.

DYNAMIC REVENUE IMPACT:

By year 2023 for example, IIT revenue in Scenario 1 would be \$165 million (2.8%) below the static estimate due to HB3522's effect on the economy.

Individual Income Tax Revenue (\$millions)	2019	2020	2021	2022	2023
Scenario 1	(119.8)	(141.9)	(156.0)	(162.3)	(165.2)
Scenario 2	17.6	13.0	12.0	15.1	19.5
Scenario 3	155.2	168.2	180.4	192.8	204.6

By year 2023 for example, sales tax revenue in Scenario 1 would be \$69 million (6.7%) below the static estimate due to HB3522' effect on the economy.

Sales Tax Revenue (\$millions)	2019	2020	2021	2022	2023
Scenario 1	(61.9)	(63.7)	(66.3)	(67.7)	(69.1)
Scenario 2	(42.7)	(43.6)	(45.2)	(46.1)	(47.1)
Scenario 3	(23.5)	(23.5)	(24.1)	(24.5)	(25.0)

Scenario 1: All net new revenue is used to pay debt.

SCENARIO 1	Units	2020	2025	2030	2035	2040
Total Employment	Thousands (Jobs)	-40.5	-40.9	-39	-41.3	-43.1
Private Non-Farm Employment	Thousands (Jobs)	-37.6	-36	-33.7	-35.9	-37.8
Population	Thousands	-41.8	-104	-133	-147	-151
Labor Force	Thousands	-31.3	-57.7	-67	-72	-76.7
Gross Domestic Product	Billions of Fixed (2009) \$	-3.48	-3.81	-3.86	-4.22	-4.55
Personal Income	Billions of Current \$	-2.97	-4.66	-5.84	-7.23	-8.74
Disposable Personal Income	Billions of Current \$	-6.99	-9.12	-10.9	-12.9	-15.1
PCE-Price Index	2009=100 (national)	-0.05	-0.08	-0.08	-0.08	-0.08
Unemployment Rate	Proportion	0.55	0.35	0.2	0.14	0.09

Scenario 2: Half of the net new revenue is used to pay debt, while the other half is used to increase current state government spending.

SCENARIO 2	Units	2020	2025	2030	2035	2040
Total Employment	Thousands (Jobs)	-5.19	-6.83	-6.88	-8.99	-10.3
Private Non-Farm Employment	Thousands (Jobs)	-19.8	-20	-19.7	-21.7	-23
Population	Thousands	-29.9	-74	-94.4	-103	-105
Labor Force	Thousands	-20.2	-36.4	-43.4	-46.7	-50.2
Gross Domestic Product	Billions of Fixed (2009) \$	-0.57	-0.82	-0.89	-1.11	-1.26
Personal Income	Billions of Current \$	-0.2	-0.89	-1.35	-1.92	-2.47
Disposable Personal Income	Billions of Current \$	-4.69	-5.98	-7.15	-8.5	-9.91
PCE-Price Index	2009=100 (National)	-0.02	-0.02	-0.01	-0.01	0
Unemployment Rate	Proportion	0.11	0.11	0.08	0.07	0.06

Scenario 3: All net new revenue is used to increase current state government spending.

SCENARIO 3	Units	2020	2025	2030	2035	2040
Total Employment	Thousands (Jobs)	30.12	27.23	25.28	23.37	22.55
Private Non-Farm Employment	Thousands (Jobs)	-2	-4.02	-5.67	-7.46	-8.25
Population	Thousands	-18.1	-44.3	-55.4	-59.3	-58.5
Labor Force	Thousands	-9.07	-15.2	-19.8	-21.4	-23.8
Gross Domestic Product	Billions of Fixed (2009) \$	2.35	2.17	2.09	2.01	2.02
Personal Income	Billions of Current \$	2.58	2.88	3.16	3.4	3.82
Disposable Personal Income	Billions of Current \$	-2.38	-2.83	-3.38	-4.05	-4.67
PCE-Price Index	2009=100 (Nation)	0.01	0.04	0.06	0.07	0.07
Unemployment Rate	Proportion	-0.33	-0.13	-0.04	0.01	0.03

Employment depend heavily on the scenario considered: Under scenario 1 there is a big loss in employment. Scenario 3 results in job gains:







Final comments:

- The dynamic analysis indicates that this net tax increase has a negative impact on the Illinois economy. The breadth and magnitude of the negative impact, however, depends heavily on how the net increase in state revenue is spent within the model.
- Be diligent and analyze the policy scenario from different points of view.
- Fully document your work.
- Communicate your results to all policy makers involved in the proposal.