

**Written Testimony
U.S. Senate Committee on Finance**

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Tax relief has been atop Gov. George H. Ryan's agenda for Illinois. Gov. Ryan has championed returning money to taxpayers, a theme that President George W. Bush has sounded on the federal level. In the current fiscal year, Illinois citizens will enjoy more than \$1 billion in tax relief that was not available when Gov. Ryan took office, including higher personal exemptions for all Illinoisans, refinements to the corporate income tax apportionment formula, suspension of sales tax on motor fuel, and enactment of a new tuition tax credit.

As part of that tax relief, Illinois Gov. Ryan and state lawmakers enacted a series of tax relief programs in the spring of 2000 under which:

- 2.3 million homeowners received rebates,
- senior citizens saw expansion of our Circuit Breaker program, particularly the portion that helps purchase prescription medicines, and
- low-income working families were given a state Earned Income Credit.

The Illinois Earned Income Credit is 5 percent of the federal EIC. It is non-refundable.

The Illinois EIC adds one line to the Illinois tax return and a worksheet to the tax booklet.

We anticipate that 700,000 residents will receive the Illinois EIC in the first year, and that total credits will be about \$35 million. The average Illinois EIC will be about \$50.

So far this filing season, we have seen 290,156 taxpayers claim the credit (24 percent of all filers) for \$24.2 million, or an average of \$84 per return. We believe those with largest EICs file early, and we anticipate both the percentage of filers and the per return credit amount will decline as the tax season progresses.

As constituted, the Illinois EIC represents affordable tax relief that can be effectively administered. The bottom line for these filers is that they receive a larger state income tax refund when they file their tax returns.

Under a flat rate income tax, as mandated by Illinois Constitution, two things can be done to reduce the burden on low-income filers:

1. The personal exemption can be increased, and
2. A state Earned Income Credit can be given.

Illinois has done both. The 2000 returns mark the final step in a three-year phase in of a doubled personal exemption and include the new Illinois EIC.

The Illinois EIC fits with Gov. George H. Ryan's and President George W. Bush's goals of reducing the burden on taxpayers. For example,

Single mother, one child, earning \$9 per hour – gets an Illinois EIC of \$69 reducing her Illinois taxes by 15.7 percent.

Single mother, two children, earning \$12.50 per hour – gets an Illinois EIC of \$54, reducing her taxes by 9.1 percent.

Single person between ages 25 and 65 earning \$8,000 per year – gets an Illinois EIC of \$9, reducing his or her taxes by 5.1 percent.

Illinois and four other states, Iowa, Maine, Oregon, and Rhode Island have non-refundable credits.

Nine states (Colorado, Kansas, Maryland, Massachusetts, Minnesota, New Jersey, New York, Vermont, and Wisconsin) and the District of Columbia have refundable credits. A table displaying the characteristics of various state EIC programs is attached.

In Illinois we can accommodate a non-refundable credit within the structure of our refund fund, which receives a fixed percentage of all income tax collections in order to repay any taxpayer's overpayment of taxes owed.

We can not accommodate a refundable credit within this structure because it would require payment of amounts never paid in by taxpayers. The amount of the EIC that exceeded taxpayers' liability would require an additional funding source or would result in a shortage of money to repay those taxpayers who overpaid their taxes.

We expect to see errors involving the Illinois EIC – math errors and other mistakes. The non-refundable nature of the Illinois credit will reduce exposure to fraud, because a taxpayer cannot receive an Illinois refund larger than what he or she paid in Illinois tax.

Illinois performs some edits before allowing the Illinois EIC, but much of our compliance will be as a result of Internal Revenue Service actions. The same is true for the other states with an EIC. A recent General Accounting Office report showed that one quarter of the federal EIC claims are erroneous. When the IRS reduces or disallows a federal EIC, that will affect Illinois.

Quite frankly, the biggest drawback to this whole program is the complexity of the federal EIC, which must be determined before a taxpayer calculates the state credit. To claim the federal EIC, taxpayers must navigate seven pages of EIC instructions and worksheets included in the federal tax booklet. There's a separate 56-page federal instruction booklet for the federal EIC; the entire Illinois tax booklet is only 36 pages long.

So far, 90 percent of those who have claimed the Illinois EIC have used a preparer.

There are limited numbers of volunteer sites that provide free assistance and the IRS is cutting back on its return preparation in Illinois.

It's unfortunate that many of these taxpayers have to pay to have their returns prepared.

In recognition of the complexity of the program, the IRS offers to calculate the federal EIC for taxpayers who submit information on paper returns. Taxpayers who choose that option would have to wait to file their Illinois return or file an amended Illinois return to claim their Illinois EIC.

I would encourage three things:

[o] Any simplification of the federal EIC that is possible should be enacted. The current complexity increases errors and reduces participation in the program. Given that compliance, accuracy and participation in state programs are largely contingent on the federal program, such simplification will improve both state and federal programs. I believe that the IRS has some proposals in this regard that would align definitions of earned income and dependent children between the EIC and the federal tax code and make other simplifications.

[o] Additional resources to allow the IRS to assist taxpayers who cannot afford to go to a preparer would save low-income taxpayers money and assure that Illinois and other states receive accurate returns.

[o] Given the historic problems with the federal EIC and the linkage with the Illinois EIC, the IRS could be given authority to recover both federal and state EICs that were issued incorrectly. This would leave taxpayers dealing with only one tax agency.