MUSINGS ON DEARTH AND TAXES

"BUT THAT'S NOT FAIR, MOMMY!"

As the nation, individual states and municipalities struggle to make fiscal ends meet now and down the road, here are some points to ponder as our elected officials attempt new ways to squeeze more dollars from the citizenry.

Fairness. Six-year-olds and politicians fixate on the mantra of fairness. But when it comes to tax policies, fairness—or equity— is actually quite complicated. For example, most of us would agree that a family making $200,000 a year should pay more in federal income taxes (and, in the case of Illinois, more in state income taxes) than its otherwise identical unit next door earning only $100,000 annually. But how much more?

Suppose the latter family pays $15,000 in taxes. Should the family with twice the income pay (a) $20,000 in taxes? (b) $30,000? (c) $50,000? Or (d) $100,000 (which would still leave it with more after-tax income than its relatively less-well-off neighbor, and also resembles the amount this family would have paid in the early 1960s)?

There is no right answer to that question, though the vast majority of economists would likely pick (c). Why? Because a mildly—not steeply—progressive tax allays some inequality concerns without distorting people's incentives to work hard, take risks, and not engage in unproductive activities, thus reducing the size of the economic pie for everyone. This is the economist's well-known "efficiency v. equity" tradeoff and warning.

BY ALLEN R. SANDERSON

With regard to actual state income taxes in Illinois, the answer to the question posed above would be (b). Our state income tax rate—formerly 3 percent, now 5 percent as of 2011—is flat or proportional. Only seven states have a strictly proportional income tax rate; the others have a progressive rate structure akin to the federal income tax (nine states do not tax income). An alternative: a 3 percent tax on incomes under $50,000; 4 percent between $50,001 and $100,000; 5 percent from $100,001 to $200,000; and 6 percent on anything above that bar. This would put Illinois in line with other states and be less onerous to the bottom rungs on our economic ladder.

In addition, Illinois excludes many services—dry cleaning, gym memberships, hair salons, legal services—from sales taxes. These are purchased disproportionately by the relatively well-heeled; but it does not exempt, as some states do, items such as food and clothing to help blunt the overall regressive nature of sales taxes. Toss in high cigarette taxes, high gasoline taxes, and the Illinois lottery—lottery tickets are bought by those with lower incomes; the rich have more attractive options when it comes to vices—and you have a punishing set of taxes on the poor.

E-Tailers. Taxing Internet sales, as Illinois began to enforce recently, appears to level the commercial playing field with brick-and-mortar establishments. On the proverbial other hand, this is not quite a slam-dunk. Quite simply, states compete with each other—and with other countries—in a myriad of ways. As noted above, some states do not have state income taxes, others have no sales tax. As we have discovered recently, Peter—or Pat—can fleece taxpayers to pay Paul—or Boeing, Groupon, Sears, Motorola, or Hollywood studios—millions of dollars to move to Illinois or remain here.

And what about Illinois residents who drive into Indiana to buy gasoline, 4th of July fireworks, or clothes at the Michigan City outlet mall to evade Illinois taxes or restrictions? Should we tax suburban malls around Chicago because of their lower rents compared with North Michigan Avenue and Loop boutiques and department stores?

Evil Corporate Fat Cats. While nationally and more locally elected officials berate corporations for not paying their fair share of taxes, economists tend to wince at such talk. Why? Because corporations don't pay taxes; people—customers, stockholders, employees—do. Firms are more akin to tax collectors than tax payers. And companies can move their operations—and jobs—across state lines or international boundaries to avoid—not evade!—high tax rates. Can you hum "On, Wisconsin" (or Iowa, Indiana, or New Jersey, or India or ...)?

Pinching Pennies. Because of the "temporary" income tax increase, the typical family in Illinois will send $1,000 more to Springfield in 2011 compared with 2010. (For those with $100,000 incomes, the marginal hit is an extra $2,000.) Something will have to give. Fewer restaurant meals and trips to Starbucks, canceling a magazine or a premium cable television subscription, skipping a dental check-up, making fewer charitable contributions, and watching the Cubs flounder on television rather than from the upper deck? Cutting back on nothing is simply not an option. There are no free lunches and no tax fairy. ❑