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Bargain Basement Progressivity? Constitutional Flat Taxes, Demogrants, and Progressive Income Taxation

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Bargain Basement Progressivity? Constitutional Flat Taxes, Demogrants, and Progressive Income Taxation

Samuel D. Brunson*

State and local governments raise revenue in three primary ways: property, sales, and income taxes. Property and sales taxes tend to impose a higher burden on low-income households. To ensure the fairness and progressivity of their overall revenue system, states need their income tax to be sufficiently progressive.

Four states face an apparently insurmountable barrier to progressive income taxation: their state constitutions mandate that any income tax must have a flat rate, applicable to all taxpayers. Without a constitutional amendment, a difficult process, they cannot adopt marginal rates that increase as income increases.

While the impediment appears insurmountable, however, it can in fact be overcome. Moreover, it may lead these states to adopt a more progressive income tax. Through the use of a flat-rate income tax with a refundable tax credit—called a “demogrant”—states can enact a flat-rate income tax that is simultaneously remarkably progressive and is more economically efficient than an income tax with progressive marginal rates.

This type of flat-rate tax with a demogrant should meet the constitutional requirements of states with mandatory flat-rate taxes. But it does not need to be limited to those states; while legislative inertia prevents most states from shifting to a flat-rate tax with a demogrant, the successful adoption of such a tax by a constitutionally constrained state may encourage other states without constitutional constraints to consider this more efficient model of progressive income taxation.

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I. INTRODUCTION

State and local governments collect just over \$1 trillion in tax revenue annually.¹ At the state level, income taxes make up the largest source of revenue (except in the South, where they are second to sales-tax revenue).² Throughout the United States, sales and income taxes make up almost seventy percent of state tax revenue.³ At the local level, the picture changes substantially. Local governments, including school districts, rely on property taxes for seventy to seventy-five percent of their revenue.⁴

State and local tax revenue represent a significant amount of taxpayer money, but their revenue combined is dwarfed by federal tax revenue. The Congressional Budget Office has anticipated the federal government will collect about \$3.8 trillion in revenue for fiscal year 2021, almost four times the amount state and local governments raise.⁵ Slightly more than half of that revenue comes from federal income taxes.⁶ Payroll taxes make up another thirty-four percent of federal revenue, while corporate income taxes and other sources of revenue provide the remainder of the federal government's funds.⁷

In addition to raising almost four times as much revenue as their

1. U. S. CENSUS BUREAU, STATE GOVERNMENT TAX COLLECTIONS SUMMARY REPORT: 2020, at 1 (2021), <https://www.census.gov/library/publications/2020/econ/g20-stc.html> [https://perma.cc/ZYN6-HXNA].

2. SARAH ANDERSEN ET AL., STATE GOVERNMENT TAX COLLECTIONS SUMMARY REPORT: 2019, at 2 (2020), https://www.census.gov/content/dam/Census/library/publications/2019/econ/g19-stc_summary.pdf [https://perma.cc/844Z-YSBT].

3. *Id.*

4. *State & Local Revenue*, NAT'L ASS'N OF STATE RET. ADM'RS, <https://www.nasra.org/revenue> (last visited Apr. 30, 2022) [https://perma.cc/NG9K-FUVD].

5. *Revenue Projections for FY2021*, CONG. BUDGET OFF. (July 1, 2021), <https://www.cbo.gov/topics/taxes> [https://perma.cc/P4E8-JGFB].

6. *Id.*

7. *Id.*

counterparts on the state level, federal taxes are generally more salient to taxpayers. California has the highest state marginal income tax rate at 13.3 percent.⁸ By contrast, the current top federal marginal income tax rate is thirty-seven percent.⁹ Moreover, to pay the top California rate, an unmarried California taxpayer would need taxable income in excess of \$1 million.¹⁰ By contrast, in 2022, an unmarried taxpayer who earns taxable income of \$539,900 pays taxes at the top federal marginal rate.¹¹ Taxpayers, then, pay higher rates of federal income tax at lower levels of income. Understandably, they pay more attention to their federal income tax.

But while state and local taxes are smaller in scope and amount than federal taxes, state and local taxes—and especially their mix of income, sales, and property taxes—represent a critical part of taxpayers’ lived experience. After all, state and local government provide services that citizens enjoy on a daily basis, and citizens interact with state and local governments far more frequently than they interact with the federal government.¹² These sub-federal governments fund first responders and libraries.¹³ They provide education and driver’s licenses.¹⁴

And state and local governments provide these services with a funding model that falls most heavily on the lowest-income taxpayers.¹⁵ As a result, lower-income taxpayers face a disproportionate share of the cost of state and local government services, or else they face fewer and lower-quality services.

To the extent state and local governments want to reduce or eliminate their regressive tax burdens, they generally do so through a progressive income tax.¹⁶ But many state income taxes are insufficiently progressive to make up for the regressive nature of their other sources of revenue. Seven states lack an income tax at all, while another nine have a flat-rate

8. Timothy Vermeer & Katherine Loughead, *State Individual Income Tax Rates and Brackets for 2022*, TAX FOUND. (Feb. 15, 2022), <https://taxfoundation.org/publications/state-individual-income-tax-rates-and-brackets/> [<https://perma.cc/B5DQ-FHKB>].

9. I.R.C. § 1(j)(2)(A). In 2026, this top rate will revert back to 29.6 percent. *Id.* § 1(i)(3)(A)(ii), (j)(1).

10. Vermeer & Loughead, *supra* note 8.

11. Rev. Proc. 2021-45, 2021-48 I.R.B. 764 § 3.01.

12. *State and Local Government*, THE WHITE HOUSE, <https://www.whitehouse.gov/about-the-white-house/our-government/state-local-government/> (last visited Apr. 30, 2022) [<https://perma.cc/TQ5M-N6GG>].

13. *Id.*

14. *Id.*; see also J. RICHARD ARONSON & JOHN L. HILLEY, *FINANCING STATE AND LOCAL GOVERNMENTS* 1 (4th ed. 1986) (explaining that local government bears major responsibility for providing civilian services in United States).

15. See *infra* notes 23–24 and accompanying text.

16. In a progressive tax regime, as income increases so do the marginal tax rates the taxpayer must pay. Jonathan Barry Forman & Roberta F. Mann, *Borrowing from Millennials to Pay Boomers: Can Tax Policy Create Sustainable Intergenerational Equity?*, 36 GA. ST. U. L. REV. 799, 801 (2020).

tax,¹⁷ which does nothing to increase the progressivity of the overall state and local tax burden.

While five of the states with flat-rate taxes have deliberately decided to avoid progressivity in their income taxes, four face significant hurdles in creating a more progressive tax. These four states have constitutional prohibitions on graduated income tax rates.¹⁸

Changing constitutional limitations is both practically and politically difficult. But the four states with constitutionally mandated flat-rate taxation do not have to change their constitutions to create a progressive state income tax to balance out the regressivity of other state and local taxes. Rather, they can add a demogrant—a refundable tax credit for all taxpayers in the state—to their flat-rate income tax. The demogrant creates progressivity in their income tax even while maintaining the constitutionally mandated single rate applicable to all taxpayers. Moreover, the progressivity of a flat-rate income tax with a demogrant is not bargain-basement progressivity—in many ways, a flat-rate income tax with a demogrant is both more progressive and more efficient than an income tax with progressive marginal tax rates.

Section II of this Article expands on the regressive nature of state taxation. It describes in greater detail how property tax and sales tax fall more heavily on lower-income taxpayers. It discusses the history of such taxation and its perpetuation, including how the way state and local taxation developed is linked in many cases to the disenfranchisement of Black taxpayers. It considers how income taxation can ameliorate some of the regressive effects of other state and local taxes, as well as discussing the states that have progressive income taxes and the states that do not. It highlights the states with a constitutional prohibition on expressly progressive marginal income tax rates.

Section III digs down into one of those states: Illinois. Through the history of Illinois's 1970 constitutional convention, Section III demonstrates that the state's rejection of progressive marginal tax rates was a political compromise, occasioned less by an aversion to progressivity and more by the perceived failures of the federal income tax. It illustrates how Illinois's delegates to the constitutional convention recognized that, notwithstanding the flat-rate income tax they enshrined in the state constitution, the Illinois income taxation they were discussing would be effectively progressive.

Section IV introduces the concept of a demogrant (that is, a refundable

17. Vermeer & Loughhead, *supra* note 8. Under a flat-rate tax, all taxpayers pay the same tax rate, irrespective of their income. See Eric Kades, *Drawing the Line Between Taxes and Takings: The Continuous Burdens Principle, and Its Broader Application*, 97 NW. U. L. REV. 189, 204, 240 (2002).

18. See *infra* note 49 and accompanying text.

tax credit available to all taxpayers). It discusses how demogrants work, why demogrants have been political nonstarters over the last several decades, and whether public opinion may have shifted since then. It then proceeds to demonstrate, using Illinois as an example, how a demogrant transforms a flat-rate income tax into an effectively progressive income tax.

Enacting a demogrant would be useless, though, if it violated a state's constitutional limitations on income taxation. Part V addresses questions of constitutionality. It shows both that Illinois law expressly allows for tax credits—including refundable tax credits—and that Illinois courts have not used the constitution's flat-rate requirement to strike down those credits. Part V proceeds to discuss—more briefly—the legal regimes in the other three states with constitutional prohibitions on progressive marginal tax rates.

Further, the benefits of a demogrant are not limited to states that cannot enact a tax with progressive rates. Part V concludes by explaining the inertial barriers other states would face in switching to a flat tax with a demogrant, even if that type of tax regime would be better than their current income tax systems. But the four states that cannot enact progressive rates have an incentive to overcome inertia and, if the demogrant works in one or more of those states, it could provide incentive for other states to switch their marginal rate income tax for an income tax with a demogrant.

II. REGRESSIVITY AND STATE TAXATION

Most people who think about tax policy agree that regressive taxation is undesirable.¹⁹ The reason for this undesirability is not hard to understand: Under a regressive tax, lower-income individuals pay a higher percentage of their income in taxes than higher-income individuals.²⁰ Requiring individuals with less income to pay a higher percentage of that income in taxes generally offends our sense of fairness and violates the fundamental tax policy pillar of vertical equity.²¹

And yet, many states rely overwhelmingly on regressive taxes, such as

19. See, e.g., Stanley S. Surrey, *The Federal Income Tax Base for Individuals*, 58 COLUM. L. REV. 815, 826 (1958) (“The deduction for state and local sales and excise taxes simply makes those taxes more regressive and is therefore undesirable.”); Terrence R. Chorvat, *Perception and Income: The Behavioral Economics of the Realization Doctrine*, 36 CONN. L. REV. 75, 91 (2003) (“It is generally agreed that a regressive tax, *ceteris paribus*, is undesirable.”).

20. Susan Pace Hamill, *An Argument for Tax Reform Based on Judeo-Christian Ethics*, 54 ALA. L. REV. 1, 6 (2002) (describing how Alabama's regressive income tax requires lower-income citizens to pay a greater percentage of their earnings than higher-income taxpayers).

21. Vertical equity demands that individuals with a greater ability to pay in fact pay more in taxes. Samuel D. Brunson, *Mutual Funds, Fairness, and the Income Gap*, 65 ALA. L. REV. 139, 142, 156 (2013).

sales and property taxes,²² for revenue.²³ In fact, property taxes make up nearly a quarter of state and local revenue, while consumption taxes like the sales tax make up another quarter.²⁴

It is hard to say precisely how regressive property taxes are. The extent of their regressivity depends, to some degree, on how much of the property tax landlords can pass on to renters.²⁵ Because renters tend to be poorer than homeowners, the larger the portion of the property tax they bear, the more regressive it is.²⁶ But even ignoring questions of the incidence of property tax borne by renters, property tax paid by homeowners is often regressive. Even if a state has a flat rate for its property tax, the amount of property tax a homeowner pays depends on the assessed value of the property. Lower-value homes tend to be assessed at closer to their actual value than higher-value homes, exacerbating the regressive nature of many property taxes.²⁷

Likewise, sales and other consumption taxes tend to fall more heavily on lower-income families than on higher-income ones. Low-income families spend a larger proportion of their income on consumption, rather than savings and investment, and, as a result, a larger percentage of their income goes toward sales taxes.²⁸ Moreover, during the last half-century, most states' sales-tax rates have doubled, putting more pressure on low-income family finances.²⁹

To the extent a state wants to ameliorate its regressive tax structure, it generally does so through a progressive income tax. An income tax is “the only major revenue source available to states that can meaningfully mitigate the unfairness of sales, excise, and property taxes.”³⁰ A state-level income tax does not, by itself, necessarily transform a regressive state-level tax regime into a progressive one, however. State income taxes tend to have a much smaller band of tax rates than the federal income

22. Eric Kades, *Giving Credit Where Credit Is Due: Reducing Inequality with a Progressive State Tax Credit*, 77 LA. L. REV. 359, 361 (2016) (explaining that every state in United States taxes regressively).

23. Mildred Wigfall Robinson, *Financing Adequate Educational Opportunity*, 14 J.L. & POL. 483, 513 (1998) (“Regressivity . . . is [an attribute of] . . . the taxes most utilized on the state level: income and sales taxes.”).

24. Francine J. Lipman, *State and Local Tax Takeaways Redux*, 101 TAX NOTES STATE 683, 688, 690 (2021).

25. Eric Kades, *The Natural Property Rights Straitjacket: The Takings Clause, Taxation, and Excessive Rigidity*, 51 U.C. DAVIS L. REV. 1351, 1368 (2018).

26. *Id.*

27. Daniel McMillen & Ruchi Singh, *Assessment Regressivity and Property Taxation*, 60 J. REAL EST. FIN. ECON. 155, 157 (2020).

28. Palma Joy Strand & Nicholas A. Mirkay, *Racialized Tax Inequity: Wealth, Racism, and the U.S. System of Taxation*, 15 NW. J.L. & SOC. POL'Y 265, 286 (2020).

29. *Id.*

30. *The Progressive Income Tax: An Essential Element of Fair and Sustainable State Tax Systems*, INST. ON TAX'N & ECON. POL'Y (July 1, 2012), <https://itep.org/the-progressive-income-tax-an-essential-element-of-fair-and-sustainable-state-tax-systems/> [<https://perma.cc/B52T-NDAN>].

tax.³¹ To the extent a state income tax has such a narrow band of marginal rates, it does little to increase the progressivity of the state's overall tax regime.³² In fact, because of states' heavy reliance on sales taxes, even states with a graduated income tax generally impose a regressive overall tax burden on their citizens.³³ And if a state has a flat-rate income tax, the income tax does nothing to ameliorate the regressive nature of the state tax burden.³⁴

These regressive state tax policies have roots in overt racism. For instance, in the late nineteenth century, several states worked to circumvent federal attempts to eliminate school segregation.³⁵ The current heavy reliance on property taxes can trace its roots to these segregationist efforts. To eliminate the equal funding of schools, these states and the District of Columbia apportioned school funding according to real-estate taxes paid by Black and white taxpayers.³⁶ Because Black residents tended to have less valuable property, Black schools received far less funding than white schools.³⁷ In addition to schools, disparate property-tax revenues also make it harder for local governments to fund parks, libraries, and other services.³⁸ Where a local government lacks a sufficient property tax base, it is forced to rely on more regressive taxes, which often fall more heavily on people of color.³⁹

While it is possible that some of this inequality is inadvertent, some is

31. See Kades, *supra* note 25, at 1368 (“State income taxes tend to be progressive, though much less so than the federal income tax. . . . [Some states] have only the mildest progression in rates.”); see also Vermeer & Loughead, *supra* note 8 (“In some states, a large number of brackets are clustered within a narrow income band.”).

32. See Robinson, *supra* note 23, at 513 (“The property tax is arguably a regressive tax. . . . Regressivity, however, is not an attribute unique to the property tax. The same criticism holds true for the taxes most utilized on the state level: income and sales taxes.”); see also Kades, *supra* note 25, at 1368–69 (explaining how states' tax regimes are regressive when taken as a whole).

33. Lior Jacob Strahilevitz, *The Uneasy Case for Devolution of the Individual Income Tax*, 85 IOWA L. REV. 907, 921 (2000).

34. See Robinson, *supra* note 23, at 513 (explaining how income and sales taxes can be just as regressive as property taxes); see also Kades, *supra* note 25, at 1368 n.52 (noting that even states with slightly progressive income tax rates have top rates that apply at such low income levels they are virtually flat and contribute to regressivity).

35. CAMILLE WALSH, RACIAL TAXATION: SCHOOLS, SEGREGATION, AND TAXPAYER CITIZENSHIP, 1869–1973, at 17 (2018) (discussing post-Reconstruction efforts of several Southern states to tie school funding to real estate or poll taxes).

36. *Id.* at 17–18 (detailing white officials apportioning education funds as they saw fit, creating disparities in funding for white and Black schools).

37. *Id.* at 17–18.

38. Michael Leachman, Michael Mitchell, Nicholas Johnson & Erica Williams, *Advancing Racial Equity with State Tax Policy*, CTR. ON BUDGET & POL'Y PRIORITIES (Nov. 15, 2018), <https://www.cbpp.org/research/state-budget-and-tax/advancing-racial-equity-with-state-tax-policy> [<https://perma.cc/C7FA-TPA9>] (“Since property taxes are the primary source of local government revenue, formulaic and tight limits on property tax rates make it much more difficult for localities to provide decent-quality services including schools, parks, and libraries.”).

39. *Id.* (concluding that state tax structures have disparate impacts on households of color because they are more likely to have lower income and less wealth than their white counterparts).

deliberate. A number of states impose a supermajority requirement to raise taxes.⁴⁰ Arkansas was the first to do so in 1934, requiring a three-fourths vote of both houses of the legislature to increase taxes.⁴¹ For three decades, Arkansas was unique among states for having a supermajority rule.⁴² After Congress passed the Voting Rights Act of 1965, though, several Southern states also adopted a supermajority requirement for raising taxes to prevent future tax increases resulting from the enfranchisement of Black voters.⁴³ And by the late 1970s, these requirements had also been exported to Northern states.⁴⁴ These supermajority requirements make it tremendously politically difficult to increase, for instance, a state's income tax to try to make the overall state tax regime less regressive.

To some extent, a sufficiently progressive income tax—one that did not need rate increases—would ameliorate both the regressivity and the segregationist and disenfranchising roots of this progressive taxation. But state income taxes have not proven to be the broad solution to regressivity that they could have been. In 2022, seven states imposed no income tax at all, relying solely on regressive consumption, excise, and property taxes for revenue.⁴⁵ The other forty-three imposed some kind of income tax.⁴⁶ Of those forty-three states, forty-one taxed wages.⁴⁷ Nine of the states with a state income tax on wages imposed that tax at a flat rate, doing nothing to counter the general regressivity of state taxation.⁴⁸

States have varied reasons for imposing a flat-rate income tax. Four of these nine states—Illinois, Massachusetts, Michigan, and Pennsylvania—mandate a flat tax in their constitutions.⁴⁹ The rest could enact progressive taxes but have made a political decision to enact a flat tax.⁵⁰

40. *Id.* (noting Mississippi, Arkansas, and Louisiana supermajority requirements to raise taxes).

41. KATHERINE S. NEWMAN & ROURKE O'BRIEN, *TAXING THE POOR: DOING DAMAGE TO THE TRULY DISADVANTAGED* 32 (2011).

42. *Id.*

43. *Id.* at 32–33 (identifying Louisiana, Mississippi, and Florida as examples for passage of supermajority requirements after Voting Rights Act's enactment).

44. *Id.* at 33 (noting South Dakota and Delaware's passage of supermajority requirements, which made their way to sixteen other states including Nevada, Washington, and Oklahoma).

45. Vermeer & Loughead, *supra* note 8.

46. *Id.*

47. *Id.*

48. *Id.*; see also *Individual Income Tax Structures in Selected States*, INST. FOR ILL. FISCAL SUSTAINABILITY AT THE CIVIC FED'N (Mar. 27, 2020), <https://www.civicfed.org/iifs/blog/individual-income-tax-structures-selected-states> [<https://perma.cc/M837-BYVB>].

49. ILL. CONST. art. IX, § 3(a); MASS. CONST. art. XLIV; MICH. CONST. art. IX, § 7; PENN. CONST. art. VIII, § 1.

50. See Daniel J. Hemel, *Federalism as a Safeguard of Progressive Taxation*, 93 N.Y.U. L. REV. 1, 20–21 (2018) (describing states' maintenance of flat taxes despite no constitutional mandate). Colorado has a constitutionally required flat *property* tax. COLO. CONST. art. X, § 3(1)(a). But although its constitution expressly allows the state legislature to enact a progressive income tax, Colorado still has a flat income tax. COLO. CONST. art. X, § 17; Vermeer & Loughead, *supra* note 8. Iowa similarly has imposed a flat income tax despite its lack of any constitutional mandate

Utah, for instance, passed a flat tax in 2006 and justified it in part because it had failed to index its tax brackets to inflation.⁵¹ As a result, Utah lawmakers believed shifting to a flat-rate income tax represented only a minimal change because its income tax was already effectively flat.⁵²

What are the effects of these constitutional and legislative flat-rate income taxes? The Institute on Taxation and Economic Policy points to Illinois and Pennsylvania, two of the states with constitutional prohibitions on progressive income taxes, as having “two of the most unfair state tax structures in the nation, despite having income taxes.”⁵³ And both states will have trouble escaping the bottom; the constitutional mandate they share with two other states functions as a commitment device,⁵⁴ making it significantly more difficult for future legislatures to enact a progressive income tax.

In 2020, Illinois’s attempt to fix its revenue regime to make it less regressive ran up against its constitutional entrenchment of the flat-rate tax. In 2019, both houses of the Illinois legislature adopted a bill to amend the state constitution and allow progressive income taxation.⁵⁵ Had Illinois’s flat-rate tax been merely a legislative choice, that would have been sufficient to create a fairer state tax system. But under Illinois law, a constitutional amendment requires not only a favorable vote of sixty percent of both legislative houses; it also requires three-fifths of the voters who vote on the issue (or a majority of people voting in the election) to approve the amendment.⁵⁶

Illinois voters ultimately rejected the change.⁵⁷ While the details of how to amend other states’ constitutions may vary, they, too, face a

for such. Compare with Lauren White, *Gov. Kim Reynolds Signs Flat Tax Rate into Iowa Law*, DAILY IOWAN (Mar. 1, 2022), <https://dailyiowan.com/2022/03/01/gov-kim-reynolds-signs-flat-tax-rate-into-iowa-law/> [<https://perma.cc/YU6K-NXSU>] (reporting that Iowa governor Kim Reynolds signed legislation that would transition Iowa’s currently progressive income tax into a flat-rate tax by 2026).

51. Alan Choate, *Utah Legislature Approves Flat Tax*, PROVO DAILY HERALD, Sept. 20, 2006, at A3.

52. *Id.*

53. *The Progressive Income Tax: An Essential Element of Fair and Sustainable State Tax Systems*, *supra* note 30.

54. See Aaron-Andrew P. Bruhl, *Using Statutes to Set Legislative Rules: Entrenchment, Separation of Powers, and the Rules of Proceedings Clause*, 19 J.L. & POL. 345, 375 (2003) (“A chief virtue of constitutions is that they lay down basic ground rules that cannot be changed through ordinary politics and run-of-the-mill legislation.”).

55. *Bill Status of SJRCA0001*, ILL. GEN. ASSEMBLY, <https://www.ilga.gov/legislation/BillStatus.asp?GAID=15&GA=101&DocNum=1&DocTypeID=SJRCA&SessionID=108&LegID=114006&SpecSess=&Session> (last updated May 27, 2019) [<https://perma.cc/8Q26-CSGK>] (describing bill’s status as having passed both Illinois congressional houses).

56. ILL. CONST. art. XIV, § 2(a)–(b).

57. Amanda Vinicky, *Illinois Voters Reject “Fair Tax” Amendment*, WTTW NEWS (Nov. 4, 2020, 10:41 AM), <https://news.wttw.com/2020/11/04/illinois-voters-reject-fair-tax-amendment> [<https://perma.cc/U8BT-U2XJ>].

steeper path to a progressive income tax than states without a constitutional mandate. Massachusetts also requires both legislative and voter approval to amend its constitution.⁵⁸ In 2022, Massachusetts voters will get the same opportunity that Illinois voters rejected in 2020: the chance to vote on a constitutional amendment that would allow the state to create a progressive tax regime.⁵⁹

The constitutional prohibition on progressive tax rates creates a steep impediment to states enacting multi-rate income taxes. It does not, however, prevent states from creating a progressive income tax that can offset some or all the regressivity in the overall state tax regime. Illinois's history with its flat income tax demonstrates how, even with a constitutionally mandated flat-rate tax, a state can create an effectively progressive income tax without having to overcome the hurdles a constitutional mandate creates. It could also serve as a template for states that, for political rather than constitutional reasons, have a flat-rate income tax.

III. ILLINOIS AND THE FLAT-RATE INCOME TAX

In 1932, the Illinois legislature enacted an income tax.⁶⁰ Almost immediately, a taxpayer challenged its constitutionality.⁶¹ The case worked its way to the Illinois Supreme Court. The court traced the history of constitutional taxes in Illinois, finding that the state had generally relied on property taxes for its revenue.⁶² In fact, in the 1840s, as other states began enacting income taxes to make up for revenue loss caused by bank failures and other shocks to the economic system, Illinois stood firm with its property tax.⁶³

Moreover, the court found that the state's 1870 Constitution entrenched this preference for property taxes. The state constitution mandated that the "General Assembly should raise [virtually] all needful revenue by levying property taxes on an ad valorem basis"⁶⁴ In addition to the property tax, the Illinois constitution allowed for certain occupation and franchise taxes.⁶⁵ It did not, however, allow for an income tax.⁶⁶

58. Colin A. Young, *Voters to Decide on Constitution Change That Allows 'Millionaire's Tax' on Income over \$1 Million*, WBUR NEWS (June 9, 2021), <https://www.wbur.org/news/2021/06/09/Massachusetts-millionaires-tax-vote> [<https://perma.cc/4KPV-YTCN>].

59. *See id.* (noting that both houses of Massachusetts legislature voted 159-41 to allow voters to weigh in on proposed four percent surtax on household income over \$1 million).

60. *Bachrach v. Nelson*, 182 N.E. 909, 910 (Ill. 1932), *overruled by* *Thorpe v. Mahin*, 250 N.E.2d 633 (Ill. 1969).

61. *Id.*

62. *Id.* at 911-13.

63. *Id.* at 912.

64. *Id.* at 913.

65. *Id.*

66. *Id.* at 915.

The court did not stop there. It also found that income was property.⁶⁷ A tax on income, then, could be construed as a tax on property. But the constitution required uniform taxes on property.⁶⁸ Even if an income tax slipped within the constitution's revenue bounds, a "tax upon property (income) by means of a graduated scale that increases in rate as applied to increases from property and personal earnings" violated the constitutionally mandated uniformity.⁶⁹

Ultimately, the court held that an income tax violated the state constitution, whether it was characterized as an income tax *or* as a property tax.⁷⁰ With that, Illinois abandoned the income tax for several decades. But by the 1960s, the surplus the state had accumulated during World War II had fallen by ninety percent.⁷¹ Meanwhile, taxes, including property tax rates, were steadily rising.⁷² By the mid-1960s, a group of lobbyists introduced a revenue proposal for the state that, among other things, called for a flat, five percent tax on individual and corporate income.⁷³

Around the same time lobbyists requested a state income tax, Illinois Democrats and Republicans rejected the idea and joined forces to reiterate both parties' opposition to an income tax.⁷⁴ Two years later, though, in their 1968 convention, Illinois Democrats ended the ten-year-old plank in their platform opposing a state income tax, citing the need for additional revenue.⁷⁵ Less than two weeks later, Illinois Republicans opened the door to considering a state income tax in their party platform.⁷⁶

A year later, the Illinois legislature enacted a state income tax.⁷⁷ Under its 1969 income tax, individuals, trusts, and estates paid a 2.5 percent tax on net income, while corporations paid four percent.⁷⁸ The governor signed the bill, the final step toward opponents needed to mount a judicial challenge to the state income tax.

Unsurprisingly, taxpayers immediately took advantage of their

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. See JOYCE D. FISHBANE & GLENN W. FISHER, *POLITICS OF THE PURSE: REVENUE AND FINANCE IN THE SIXTH ILLINOIS CONSTITUTIONAL CONVENTION* 9 (1974) (describing decline in revenue surplus following World War II).

72. *Id.*

73. *Id.* at 16.

74. George Tagge, *Dems O.K. Revenue Plan: Oppose State Income Tax in Platform*, CHI. TRIB., Sept. 10, 1966, at 1.

75. George Tagge, *Dems End Income Tax Ban: State Parley Shifts Stand in Platform*, CHI. TRIB., Sept. 18, 1968, at 1.

76. George Tagge, *G.O.P. Backs Tax Rebates: Party Opens Door to State Income Levy*, CHI. TRIB., Sept. 28, 1968, at 1.

77. George Tagge, *State Income Tax Passed: Ogilvie Will Sign It, Seek Court Test*, CHI. TRIB., July 1, 1969, at 1.

78. *Id.*; see also *Thorpe v. Mahin*, 250 N.E.2d 633, 634 (Ill. 1969) (detailing provisions of Illinois Income Tax Act challenged by taxpayers).

opportunity to challenge the new income tax as unconstitutional.⁷⁹ Their argument relied heavily on the state supreme court's 1932 decision in *Bachrach*.⁸⁰ But in the ensuing decades, the court changed its mind. Because the incidence of income and property taxes differed, it decided an income tax was not a property tax.⁸¹ As such, it was not subject to the state constitution's uniformity requirement.⁸² If the state could constitutionally enact an income tax, that tax could have progressive rates.

The court then proceeded to dismiss as dicta its earlier assertion that the constitution limited the state to enact property, occupation, and franchise taxes.⁸³ After reviewing voluminous scholarship disputing this dicta, the court "disavowed" its earlier conclusion.⁸⁴ The Illinois Supreme Court held the General Assembly, "has the power to impose a tax on the privilege of earning or receiving income in or as a resident of Illinois."⁸⁵

After more than a century of relying primarily on property taxes, and after almost four decades believing that the state constitution prohibited income taxation, suddenly Illinois had an income tax. And its ability to impose an income tax was apparently unconstrained by legal or constitutional limitations.

At the same time the state enacted an income tax, it was considering whether to update its constitution.⁸⁶ Some Illinoisans believed that the state's constitution—nearly a century old—was "archaic" and needed an update.⁸⁷ The state had tried, fifty years earlier, to update its constitution, but its attempt was thwarted, in part because the proposed 1920 constitution authorized an income tax, something "[s]ubstantially everybody in the state" opposed.⁸⁸ And the question of income taxation played a significant role in the state's 1970 constitutional convention. While there was "little discussion of prohibiting income taxation in the new constitution," the public was not in favor of unrestricted income taxes.⁸⁹ If delegates wanted Illinois voters to approve a new state constitution, among other things, they would have to present a salable income tax provision to the public.⁹⁰

79. *Thorpe*, 250 N.E.3d at 634.

80. *Id.*

81. *Id.* at 636.

82. *Id.*

83. *Id.*

84. *Id.* at 637.

85. *Id.* at 638.

86. See Sheila Wolfe, *State Constitution: Revision Needed?*, CHI. TRIB., July 19, 1968, at A3 (reporting on growing support for a constitutional convention in Illinois).

87. *Id.*

88. *Id.*

89. FISHBANE & FISHER, *supra* note 71, at 80.

90. *Id.* ("Salability of the income tax provision was critical to approval of the final document.").

A. Non-Graduated Rate

The Illinois public was willing to pay an income tax, especially if that income tax would replace the deeply unpopular state personal-property tax.⁹¹ But the public—who had to approve any new constitution with a supermajority vote—worried that permitting an income tax without any limits would lead to an extreme degree of graduation, with the wealthy exploiting loopholes in the law to pay less in taxes than the middle class and the poor.⁹² They also worried that without constraints, the tax would only ratchet up. Martin Ozinga, a delegate to the state constitutional convention, explained “that the federal income tax, when it was instituted in the early part of this century, would not exceed, I believe, 4 percent—that this would be more than adequate to take care of the needs.”⁹³

By the late 1960s, both of these concerns would have at least some justifications. In 1969, the federal income tax had twenty-five marginal tax brackets, ranging from fourteen to seventy percent.⁹⁴ And the threat of the wealthy using loopholes to avoid federal income taxes was extremely salient. As Congress worked to reform the federal income tax, it had to deal with public outrage at disclosures that 154 millionaires had paid no taxes in 1966.⁹⁵

Whether or not a graduated tax automatically created loopholes to benefit the wealthy, delegates to the constitutional convention believed they did. Delegate Durr submitted that “a graduated tax is absolutely the worst thing you can visit on the taxpayers of this state, particularly those in the lower to middle brackets.”⁹⁶ Why? Because the “absolutely unavoidable effect of graduated rates is to grant the inducement and the equitable strength of position to create the loopholes that benefit no one but [the wealthy].”⁹⁷

Naturally, of course, delegates were not *only* worried about poor and middle-class taxpayers. They also worried that the unlimited ability to create additional marginal tax rates would eventually lead to confiscatory

91. *See id.* at 80–82 (noting public opinion on newly proposed state income tax).

92. *See id.* at 146 (describing concerns about loopholes in graduated federal income tax).

93. SIXTH ILLINOIS CONSTITUTIONAL CONVENTION, 3 REC. OF PROC. 1875 (1972) [hereinafter ILL. CONST. CONVENTION REC. OF PROC.].

94. *Historical U.S. Federal Income Tax Rates & Brackets, 1862–2021*, TAX FOUND. (Aug. 24, 2021), <https://taxfoundation.org/historical-income-tax-rates-brackets/> [<https://perma.cc/SNM3-QVQ7>]. Taxpayers filing as head of household faced the same range of marginal tax brackets but divided into thirty-three rates. *Id.*

95. *See* William Bromage, *Tax “Loopholes”: Investors’ Guide*, CHI. TRIB., Aug. 31, 1969, at B7 (reporting on tax loopholes that allowed 154 millionaires to avoid paying income taxes in 1966). In fact, this reported tax evasion led to the enactment of the alternative minimum tax. *See* Gabriel O. Aitsebaomo, *The Individual Alternative Minimum Tax: An Argument in Favor of Repeal*, 74 UMKC L. REV. 335, 338 (2005) (asserting that millionaires’ tax avoidance in 1966 led to alternative minimum tax).

96. ILL. CONST. CONVENTION REC. OF PROC., *supra* note 93, at 1877.

97. *Id.*

taxation.⁹⁸ Again pointing to the federal income tax, delegates argued that between a fifty-two percent corporate tax rate and a top individual marginal rate of ninety-one percent, “some taxpayers under that system could end up being permitted to retain maybe 4 percent of the income earned by their property. We submit that that is not desirable.”⁹⁹

The delegates batted around a handful of different ideas about how to ensure that the state income tax did not follow the federal model of encouraging the wealthy to find loopholes and pass the cost of government to the non-wealthy. They ultimately landed on two backstops to prevent the kinds of abusive tax regime they wanted to avoid. First, the state constitution requires any income tax to be imposed at a “non-graduated rate.”¹⁰⁰ And the delegates were careful to ensure that the legislature could not bypass this requirement by, for example, stacking multiple income taxes with different rates and different exemption amounts on top of each other.¹⁰¹ To prevent this kind of stacking, the constitution also provides that “[a]t any one time there may be no more than one such tax imposed by the State for State purposes on individuals and one such tax so imposed on corporations.”¹⁰²

Second, to ensure that the personal and corporate income taxes did not diverge too radically, the delegates created a maximum permissible ratio between corporate and personal tax rates.¹⁰³ Under the constitution, the corporate rate cannot exceed the individual rate by “more than a ratio of 8 to 5.”¹⁰⁴ Subject to these limitations, Illinois’s 1970 constitution explicitly permitted an income tax for the first time.¹⁰⁵

98. *See id.* at 1876 (noting concerns that a graduated system could leave some taxpayers with very little income after taxes).

99. *Id.* This concern represents a misunderstanding of progressive taxation. A ninety-one percent top marginal rate does not mean that a taxpayer pays ninety-one percent of their income in taxes; rather, it means that they pay ninety-one percent of their income in excess of a certain amount. In 1963, the last year with a ninety-one percent marginal tax rate, a married couple would only pay taxes at a ninety-one percent rate on income they earned in excess of \$400,000. *Historical U.S. Federal Income Tax Rates & Brackets, 1862–2021*, *supra* note 94. In fact, during the 1950s, when the top marginal rate fluctuated between ninety-one and ninety-two percent, “the top 1 percent of taxpayers paid an average of 42.0 percent of their income in federal, state, and local taxes.” Scott Greenberg, *Taxes on the Rich Were Not That Much Higher in the 1950s*, TAX FOUND. (Aug. 4, 2017), <https://taxfoundation.org/taxes-on-the-rich-1950s-not-high/> [<https://perma.cc/244P-ENG4>].

100. ILL. CONST. art. IX, § 3(a).

101. *See* FISHBANE & FISHER, *supra* note 71, at 108 (identifying delegates’ concerns about multiple income taxes with varying levels of rates and exemptions, effectively enacting graduated income tax).

102. ILL. CONST. art. IX, § 3(a).

103. FISHBANE & FISHER, *supra* note 71, at 81–82 (explaining that delegates voted to limit differential between corporate and personal tax rates to an eight-to-five ratio).

104. ILL. CONST. art. IX, § 3(a).

105. *People v. Clay*, 521 N.E.2d 243, 250 (Ill. App. Ct. 1988) (“Section 3 was added to article IX so that the Illinois Constitution of 1970 would embody the *Thorpe* court’s decision to uphold the Illinois Income Tax Act of 1969.” (citing *Thorpe v. Mahin*, 250 N.E.2d 633 (Ill. 1969))).

But even as the delegates debated these limitations on any future state income tax, they recognized that the state did not have to—and in fact would not—have a truly flat tax. Delegate Kenney acknowledged that a flat-rate tax could achieve some degree of progressivity by providing taxpayers an exemption amount.¹⁰⁶ The state’s existing income tax did precisely that, allowing a \$1,000 exemption for each family member.¹⁰⁷ In his mind, though, that type of graduation differed fundamentally from explicitly graduated rates.¹⁰⁸ The delegates’ goal was not to prevent any and all effective progressivity.¹⁰⁹ Instead, as they drafted the constitution, the delegates were “saying what we mean”; higher incomes would not face higher marginal tax rates.¹¹⁰

Delegate Durr agreed, arguing that “to say that the people of this state are so stupid that they can’t figure it out that a flat rate tax isn’t flat in its effective application because of the differing exemptions doesn’t do justice or credit to the people of this state.”¹¹¹ Even though the tax was not flat in effect, though, he believed that its formal lack of graduated rates would “protect [Illinois taxpayers] from the mischief that we have seen at the federal level for the last twenty-five years.”¹¹² Ultimately, concern that Illinois’s income tax not devolve into the federal income tax seemed to be the primary consideration in delegates’ push for a flat-rate tax.

Not only did delegates know that deductions and exclusions could transform a flat-rate income tax into an effectively progressive tax, they also believed that courts would uphold this type of progressivity. Delegate Maurice Scott explained that both Illinois courts and courts in other states with flat taxes had permitted the “General Assemblies of the states to allow deductions and credits and so forth and define what then is taxable income, and then by a flat rate is a flat rate to apply against that.”¹¹³ He continued that even under Illinois law at the time, the courts had treated the state’s income tax as a flat-rate tax “although there can be manipulations as far as deductions and exemptions and the amounts therefore.”¹¹⁴

The delegates’ goal in drafting a constitutional prohibition on graduated income tax rates was not, then, to prevent progressivity. Delegates recognized the “basic fact” that “the progressive is a fairer tax.”¹¹⁵ Rather,

106. ILL. CONST. CONVENTION REC. OF PROC., *supra* note 93, at 1950.

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.* at 1949.

112. *Id.*

113. *Id.* at 1874.

114. *Id.*

115. *Id.* at 1870.

they wanted to create a provision that Illinois voters would accept. They further believed, based on their experience, that graduated rates burdened the middle class most heavily and that graduated rates created incentives for the wealthy to shirk their taxpaying responsibilities.¹¹⁶

The delegates could have drafted the state constitution to prohibit any progressivity in the income tax. Delegate Scott pointed out that they could have imposed the flat-rate tax on taxpayers' gross income.¹¹⁷ By eliminating all deductions and tax credits, the constitution could have ensured that the income tax was strictly proportional, not progressive. But they chose not to, in part, because delegates believed "that kind of graduation is vastly different than the kind of graduation that could be introduced if there is no prohibition on a flat-rate tax."¹¹⁸

B. Progressivity in Spite of a Flat-Rate Tax

Deductions and credits in Illinois's constitutionally mandated flat-rate income tax create a type of effective progressivity. That effective progressivity protects the poor, and especially the poor with large families, from bearing an undue tax burden.¹¹⁹ The progressivity provided by extant deductions and credits is limited, however.

The primary source of this mild progressivity is through the state's standard exemption. Under Illinois law, taxpayers pay taxes on their net income.¹²⁰ To calculate net income, an Illinois taxpayer starts with their federal adjusted gross income, with some state-specific modifications.¹²¹ They then move from this base income to net income by deducting their standard exemption.¹²² Each taxpayer deducts a separate, inflation-adjusted standard exemption for themselves, their spouse, and any dependents.¹²³ In 2021, the standard exemption in Illinois was \$2,375.¹²⁴

Because of the standard exemption, a family of four in Illinois does not pay any state income tax on its first \$9,500 of income. While the state

116. *Id.* at 1870, 1873 (discussing impact of graduated rates on middle- and high-income earners).

117. *Id.* at 1874.

118. *Id.* at 1950.

119. *See id.* at 1866 ("[T]his language would permit a reverse graduation which would recognize the lesser ability to pay for poor families or perhaps large families or those which are both poor and large.").

120. 35 ILL. COMP. STAT. 5/201(a).

121. 35 ILL. COMP. STAT. 5/203(a).

122. 35 ILL. COMP. STAT. 5/202.

123. 35 ILL. COMP. STAT. 5/204(a), (c). Section 204(a) allows this standard exemption for each taxpayer. Section 204(c) provides for an additional exemption for each person who would qualify for a personal exemption under Section 151 of the Internal Revenue Code. Under the Code, spouses and dependent children qualify. I.R.C. § 151(b), (c) (2018).

124. 35 ILL. COMP. STAT. 5/204(b)(5); *see also* *What Is the Illinois Exemption Allowance?*, ILL. DEP'T OF REVENUE, <https://www2.illinois.gov/rev/questionsandanswers/Pages/851.aspx> [<https://perma.cc/AT7M-EJLC>] (last visited May 3, 2022).

formally imposes a flat tax of 4.95 percent on taxpayers' income,¹²⁵ this family is not paying taxes at a 4.95 percent rate; rather, this family is paying taxes at a zero percent rate. As the family's income rises, so does its effective tax rate.¹²⁶ A family with base income of \$19,000 has an effective tax rate of 2.475 percent.¹²⁷

As an Illinois taxpayer's base income rises, so does their effective rate. A family of four with base income of \$50,000 pays \$2,004.75 in taxes, an effective rate of 4.01 percent. At \$100,000 of base income, this taxpayer's effective rate is 4.48 percent. By the time a taxpayer's base income is \$1 million, they have an effective rate of 4.9 percent, nearly the statutory rate.

This is the kind of progressivity that delegates to the state's 1970 constitutional convention acknowledged. They could have drafted the constitution to require an actual flat tax, but their concern was not with progressivity; it was with multiple tax brackets. The delegates were comfortable with progressivity itself.¹²⁸

Still, the constitution's prohibition on graduated income tax rates has proven sticky, even five decades after the enactment of the constitution. In 2020, the Illinois legislature approved putting an initiative on the ballot that would delete the constitution's flat-rate requirement.¹²⁹ To amend the constitution would require sixty percent of voters who voted on the question, or a majority of voters in the election, to approve the change.¹³⁰

As a result, Illinois voters faced a tsunami of advertising, both for and against the amendment. The state's governor, J.B. Pritzker, largely funded Vote Yes for Fairness, a group arguing on behalf of the amendment.¹³¹ Ken Griffin, founder of the Citadel hedge fund, provided the bulk of funding for groups opposed to the amendment.¹³² When it came

125. 35 ILL. COMP. STAT. 5/201(b)(5.4).

126. The *effective tax rate* is the amount of taxes a taxpayer pays divided by that taxpayer's income. With a progressive tax, it should always be lower than the taxpayer's marginal rate. See, e.g., Boris I. Bittker, *Effective Tax Rates: Fact or Fancy?*, 122 U. PA. L. REV. 780, 781 (1974) ("When the taxpayer's actual income tax liability is expressed as a fraction of a base other than taxable income, the resulting percentage is usually described as the 'effective rate.'").

127. Subtracting the \$9,500 standard exemption from the base income of \$19,000 leaves \$9,500 of net income. Multiplying the taxpayer's net income by 4.95% leaves a tax liability of \$470.25. To find the taxpayer's effective tax rate, we divide \$470.25 by \$19,000, which gives us a 2.475% effective rate.

128. See *supra* notes 106106–119 and accompanying text (detailing the thoughts of legislators during the adoption of the 1970 flat-tax rate in the Illinois Constitution).

129. Paris Schutz, *What Voters Need to Know About the "Fair Tax" Amendment*, WTTW (Sept. 15, 2020, 8:12 PM), <https://news.wttw.com/2020/09/15/what-voters-need-know-about-fair-tax-amendment> [<https://perma.cc/7KXB-JLA4>].

130. ILL. CONST. art. XIV, § 2.

131. Schutz, *supra* note 129.

132. Rick Pearson, *Tax Talk Wrapped in Hope and Fear*, CHI. TRIB. (Sept. 18, 2020), https://digitaledition.chicagotribune.com/infinity/article_share.aspx?guid=2a92935c-90cc-4b7d-8afb-42993182459d [<https://perma.cc/Q9MW-VT8W>].

time for Illinois voters to decide, they rejected the amendment by a vote of about fifty-five percent against.¹³³

Illinois's experience with its proposed shift in income tax is relatively typical. The Tax Foundation found that during the decade following 2010, when given a direct vote on income tax questions, voters chose the lower-tax option a significant majority of the time.¹³⁴

But while voters rejected the constitutional amendment, it is not clear that they reject progressive taxation. In fact, a 2019 poll of Illinois voters indicated that two-thirds support a progressive income tax, at least in theory.¹³⁵ They rejected the proposed change in large part because they lacked trust in state government and feared that the proposal would lead to the state taxing retirement income.¹³⁶

While the constitutional limits on income taxation have proven difficult to amend, with voters unable to overcome their distrust of state government to allow them to enact the graduated tax rates they would prefer, Illinois legislators have a tool they can use to increase the progressivity of their flat-rate tax: an income tax with a demogrant.

IV. DEMOGRANTS, ECONOMIC EFFICIENCY, AND POLITICS

The idea underlying demogrants is simple. A demogrant is a fixed, refundable tax credit available to all taxpayers.¹³⁷ Critically, the credit has to be refundable, which means that if a taxpayer owes less in taxes than the amount of the credit, they get money back from the government.¹³⁸

133. Amanda Vinicky, *Illinois Voters Reject "Fair Tax" Amendment*, WTTW (Nov. 4, 2020, 10:41 AM), <https://news.wttw.com/2020/11/04/illinois-voters-reject-fair-tax-amendment> [perma.cc/U8BT-U2XJ].

134. See Janelle Cammenga & Jared Walczak, *Election Analysis: Why Voters Split the Difference on Income Tax Measures*, TAX FOUND. (Nov. 4, 2020), <https://taxfoundation.org/illinois-fair-tax-income-tax-ballot-measures/> [https://perma.cc/ND72-E544] ("Between 2010 and today, when voters have weighed in on income taxes they have chosen the lower-tax option 14 out of 23 times, including 10 out of 17 votes directly on tax rates and levies.").

135. Brian Mackey, *Survey Shows Significant Support for Graduated Income Tax*, NPR ILL. (Oct. 9, 2019, 3:27 AM), <https://www.nprillinois.org/statehouse/2019-10-09/survey-shows-significant-support-for-graduated-income-tax#stream/0> [https://perma.cc/BJ53-5PNK].

136. Hannah Meisel, *Graduated Income Tax Referendum Fails, Dealing Major Blow to Pritzker*, NPR ILL. (Nov. 4, 2020, 6:58 AM), <https://www.nprillinois.org/statehouse/2020-11-04/graduated-income-tax-referendum-fails-dealing-major-blow-to-pritzker> [https://perma.cc/JS6Z-W5RB] (reporting on income tax referendum's failure, and noting exit-survey results indicating fear that a graduated tax might lead to retirement income being taxed).

137. Daniel Hemel, *Beyond the Marriage Tax Trilemma*, 54 WAKE FOREST L. REV. 661, 676 (2019). Professor Hemel argued for a per capita demogrant to solve the problem of "maintain[ing] couples neutrality within a progressive tax system." *Id.* For purposes of this Article, I am going to sidestep the problem of marriage and couples neutrality. At state income tax levels, that problem is less severe in any event.

138. Michelle Lyon Drumb, *Those Who Know, Those Who Don't, and Those Who Know Better: Balancing Complexity, Sophistication, and Accuracy on Tax Returns*, 11 PITT. TAX REV. 113, 119 (2013) ("Refundable credits are sometimes known as 'negative income tax' because the taxpayer will receive a refund of the credit to the extent it exceeds the tax due.").

To illustrate: if Illinois had a \$10,000 demogrant and a taxpayer owed \$15,000 in taxes before the credit, after applying the credit the taxpayer would owe the state \$5,000. By contrast, if the taxpayer owed \$3,000 in taxes, that taxpayer would receive a \$7,000 refund from the state.

Refundable tax credits trace an intellectual heritage back to Milton and Rose Friedman who, in 1962, proposed a negative income tax.¹³⁹ Economists like the idea of a negative income tax because, designed correctly, it combines redistribution with relatively flat-rate income taxes.¹⁴⁰ The flatter rate structure minimizes work disincentives, ultimately creating a more efficient tax system.¹⁴¹

In fact, Professors Joseph Bankman and Thomas Griffith have demonstrated that “under any welfarist social welfare function, and under reasonable assumptions regarding the components of individual utility and the nature of the economy, the optimal tax structure would redistribute income from the rich to the poor, although by means of a demogrant rather than by graduated marginal rates.”¹⁴²

A. *An Aversion to Demogrants*

In spite of economists’ support, though, the United States has never actually used a demogrant as part of its income tax regime.¹⁴³ It came close: President Richard Nixon proposed a negative income tax, but the proposal ultimately went nowhere.¹⁴⁴ At best, the idea of a negative income tax has inspired the use of refundable tax credits.¹⁴⁵

During his 1972 presidential campaign, candidate George McGovern echoed and expanded on Nixon’s proffered negative income tax. McGovern proposed a \$1,000 demogrant.¹⁴⁶ The public’s reception to his plan proved disastrous, and he quickly distanced himself from it.¹⁴⁷ “Since then, demogrants have become one of the third rails of U.S. politics—touch them and you die.”¹⁴⁸ Professors Lawrence Zelenak and Kemper Moreland posited that things may have been different if a less liberal

139. Lily L. Batchelder, Fred T. Goldberg, Jr. & Peter R. Orszag, *Efficiency and Tax Incentives: The Case for Refundable Tax Credits*, 59 STAN. L. REV. 23, 32 (2006).

140. *Id.*

141. *Id.*

142. Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CALIF. L. REV. 1905, 1966 (1987).

143. See Batchelder et al., *supra* note 139, at 33 (“[A] negative income tax has never been enacted in the United States . . .”).

144. *Id.* at 32–33.

145. See *id.* at 33 (“[T]he concept has substantially influenced policymakers as they have enacted other types of refundable credits over the past three decades that are intended more as incentives.”).

146. Lawrence Zelenak & Kemper Moreland, *Can the Graduated Income Tax Survive Optimal Tax Analysis?*, 53 TAX L. REV. 51, 60 (1999).

147. *Id.*

148. *Id.*

candidate had proposed a demogrant (though, as mentioned above, Nixon had also proposed the idea) and that general hostility toward basic-income guarantees had doomed demogrant as a realistic possibility.¹⁴⁹

Political preferences change over time, though. Perhaps today, the idea of a demogrant would prove more politically palatable. The idea of universal basic income has become more common and more popular. Between 2018 and the end of 2021, at least twenty cities and counties throughout the United States piloted guaranteed-income programs, with more than 5,000 households receiving some amount of monthly income from those programs.¹⁵⁰ This broad experimentation comes as very little surprise; in 2019, a Pew poll found that forty-five percent of Americans supported a universal basic income of \$1,000 for every adult.¹⁵¹ And there is reason to believe that it will continue to increase in popularity; about two-thirds of people under age thirty favored universal basic income.¹⁵² Moreover, there is some evidence that the economic fallout of the COVID-19 pandemic has increased people's support for some sort of cash-transfer-based welfare regime.¹⁵³

None of these polling results directly addresses a flat income tax with a demogrant, of course. Nor do they address the constitutionality of a demogrant in states with constitutions that prohibit graduated taxes. They do, however, suggest that public comfort with direct cash payments from the government to individuals has increased and that, even if a demogrant would have been political suicide half a century ago, it may be politically feasible today.

149. See *id.* at 60–61 (“The politics of demogrant also might have been different if they had been proposed by a politician viewed as less liberal than McGovern. . . . In a political climate in which even need-based welfare-as-we-know-it has been drastically curtailed, a system of universal non-need based transfers has no chance. Opinion polling confirms the unpopularity of basic income guarantees.”).

150. Sarah Holder, *The Year Basic Income Programs Went Mainstream*, BLOOMBERG (Dec. 28, 2021, 6:15 AM), <https://www.bloomberg.com/news/articles/2021-12-28/the-u-s-cities-giving-residents-direct-cash-payments> [<https://perma.cc/A6UF-YQLY>].

151. Hannah Gilberstadt, *More Americans Oppose Than Favor the Government Providing a Universal Basic Income for All Adult Citizens*, PEW RSCH. CTR. (Aug. 19, 2020), <https://www.pewresearch.org/fact-tank/2020/08/19/more-americans-oppose-than-favor-the-government-providing-a-universal-basic-income-for-all-adult-citizens/> [<https://perma.cc/WJX5-8TKS>].

152. See *id.* (“Adults under age 30 favor the government providing a UBI by roughly two-to-one (67% to 33%).”).

153. See *Might the Pandemic Pave the Way for a Universal Basic Income?*, THE ECONOMIST (Mar. 5, 2021), <https://www.economist.com/finance-and-economics/2021/03/02/might-the-pandemic-pave-the-way-for-a-universal-basic-income> [<https://perma.cc/K4LL-57Z2>] (“[T]he experience of the pandemic, and the accompanying explosion in social spending, have changed the tone of discussions about radical reforms to welfare states. Cash transfers—like those deployed many governments during the pandemic—have come to look like an efficient, effective way to meet any number of social needs.”).

B. Introducing a Demogrant into Illinois's Flat-Rate Income Tax

A demogrant introduces progressivity into a flat income tax in much the same way as tax deductions do.¹⁵⁴ The demogrant can supercharge the progressivity, though.

Imagine, for instance, that Illinois wanted to increase its progressivity but also ensure that no taxpayer with income of less than \$130,000¹⁵⁵ paid more in taxes under the new income tax than they did under the prior flat-rate regime. Imagine, too, that the state wanted the wealthiest taxpayers' income tax rate to approach eight percent.¹⁵⁶ With those constraints, the state could set its rate and its demogrant.

Under current law, a taxpayer with \$130,000 would pay approximately \$6,435 in taxes.¹⁵⁷ If the state increased taxes to eight percent, that taxpayer would pay \$10,400 in state income tax. If Illinois wanted to ensure that nobody earning \$130,000 or less paid more in tax, it could pair the new tax rate with a \$4,000 demogrant. If Illinois set its demogrant at \$4,000, it would ensure that no taxpayer earning \$130,000 or less would pay more in taxes. The household with \$130,000 would owe \$10,400 in taxes but would reduce its tax bill by the demogrant amount. The demogrant would decrease the taxpayer's net tax liability to \$6,400, \$35 less than they would have paid under the current Illinois flat tax.

While \$4,000 does not seem like a tremendously large refundable tax credit, it would transform Illinois's flat-rate state income tax into a remarkably progressive tax. With a \$4,000 refundable income tax credit, a taxpayer would have to earn more than \$50,000 in taxable income before they paid any state income tax.¹⁵⁸ A taxpayer with Illinois's median household income of \$65,886¹⁵⁹ would owe \$1,270.88 in taxes.¹⁶⁰ While the marginal rate this median taxpayer faced would be the same eight percent as every other taxpayer in the state, their effective rate would be 1.9 percent, far lower than the 4.95 percent rate they pay under current

154. *See supra* notes 119–127 and accompanying text.

155. The choice of \$130,000 is largely arbitrary and meant only for illustrative purposes. I chose \$130,000 because it is about twice the 2019 median household income in Illinois. *See QuickFacts Illinois*, U.S. CENSUS BUREAU, <https://www.census.gov/quickfacts/fact/table/IL/>, (last visited March 13, 2022) [<https://perma.cc/7Z2Q-TD2M>] (listing median household income in Illinois between 2015–2019 as \$65,886). Any state that wanted to implement a flat-rate tax with a demogrant would ultimately have to decide its own numbers.

156. Had Illinois voters approved the constitutional amendment to allow for a graduated income tax, the legislature was prepared to impose a top rate of 7.99%. Jared Walczak & Katherine Loughhead, *Twelve Things to Know About the "Fair Tax for Illinois"*, TAX FOUND. (Oct. 6, 2020), <https://taxfoundation.org/illinois-fair-tax/> [<https://perma.cc/EE8F-2GAH>].

157. That is not precise—depending on the size of the taxpayer's family, the taxpayer would reduce their income by some number of standard exemptions. *See supra* notes 120–125 and accompanying text. But for illustrative purposes, ignoring the standard exemptions will work.

158. $\$50,000 \times 8\% - \$4,000 = \$0$.

159. U.S. CENSUS BUREAU, *supra* note 155.

160. $\$65,886 \times 8\% - \$4,000 = \$1,270.88$.

law.

Consistent with progressive taxation, as a taxpayer's income increased, they would pay more in taxes. A taxpayer earning \$100,000 would pay taxes at an effective rate of four percent, still lower than their current tax rate in Illinois but higher than lower-income taxpayers.¹⁶¹ A taxpayer earning \$130,000 would pay about the same rate under this flat-rate tax with a demogrant as they do under current law.

But because the rate would be set at eight percent, the effective tax rate would continue to rise with income. A taxpayer earning \$500,000 would still get a \$4,000 demogrant, leaving them with a tax liability of \$36,000, for an effective rate of 7.2 percent.¹⁶² A taxpayer earning \$1 million would owe taxes of \$76,000, an effective tax rate of 7.6 percent.¹⁶³ And a taxpayer earning \$1 billion would owe \$79,996,000 in taxes, an effective rate of just under eight percent.¹⁶⁴

But demograts do not just increase progressivity by taxing higher-income taxpayers at higher effective rates. Because the demogrant is a refundable credit, an income tax with a demogrant literally redistributes income to lower-income taxpayers. If a taxpayer's demogrant is higher than their tax liability, they receive a cash transfer from the state. So, for instance, with an eight percent rate and a \$4,000 demogrant, a taxpayer earning \$40,000 (about fifty percent higher than the federal poverty level for a four-person household in 2021¹⁶⁵) would not only owe no taxes but would receive a transfer of \$800 from the state government.¹⁶⁶ This family would actually pay taxes at a negative two percent rate. At poverty level, they would receive a net transfer from the state of \$1,880, a negative seven percent rate. Further, a taxpayer with no income would receive \$4,000 from the government.

Illinois—or any other state that adopted a flat tax with a demogrant—would be free to adjust both the rate and the size of the demogrant, depending on how progressive it wanted its income tax to be and how much revenue it needed to raise. It could also do so without worrying about discouraging work for higher-income taxpayers.¹⁶⁷

A flat-rate tax with a demogrant also solves a problem that the Illinois constitutional delegates hinted at, though they did not raise explicitly: it

161. $\$100,000 \times 8\% - \$4,000 = \$4,000$.

162. $\$500,000 \times 8\% - \$4,000 = \$36,000$, which is 7.2 percent of \$500,000.

163. $\$1,000,000 \times 8\% - \$4,000 = \$76,000$, which is 7.6 percent of \$1 million.

164. $\$1,000,000,000 \times 8\% - \$4,000 = \$79,996,000$, which is 7.996% of \$1 billion.

165. See Annual Update of the HHS Poverty Guidelines, 86 Fed. Reg. 7732, 7733 (Feb. 1, 2021) (listing 2021 poverty guideline for a four-person household in the forty-eight contiguous states and District of Columbia at \$26,500).

166. $\$40,000 \times 8\% - \$4,000 = -\$800$.

167. See Batchelder et al., *supra* note 139, at 32 (“Many economists view a negative income tax as desirable because of its potential to combine redistribution to low-income individuals and families with relatively flat marginal tax rates that minimize work disincentives.”).

constrains the rate that higher-income taxpayers can be required to pay. Theoretically, an income tax with multiple marginal tax rates faces no such constraint; a legislature could impose astronomically high rates on high-income taxpayers while keeping rates low for lower-income taxpayers.

For example, in 1952, federal taxpayers paid a ninety-two percent marginal rate on income in excess of \$400,000.¹⁶⁸ But the lowest tax rate was 22.2 percent. The top marginal rate could rise or fall without affecting any rate below it. By contrast, in a flat tax with a demogrant, to increase taxes on high-income taxpayers, the legislature generally also has to increase the effective rate for low-income taxpayers.¹⁶⁹

V. DOES A FLAT TAX WITH A DEMOGRANT MEET CONSTITUTIONAL MUSTER?

While a flat tax with a demogrant may be good tax policy, and while it may not contradict the expectations of the delegates of the 1970 constitutional convention, it must still comply with a state's constitution. Can a state with a constitutionally mandated flat tax create progressivity through a refundable tax credit paid to everybody?

Not surprisingly, there is little case law directly on point. The only state government in the United States that currently provides demogrant is Alaska, through its Alaska Permanent Fund.¹⁷⁰ (The Alaska Permanent Fund is a constitutionally mandated fund that shares oil and other similar revenue with Alaskan residents.¹⁷¹) Alaska does not have a state personal-income tax,¹⁷² much less a constitutionally mandated flat tax, though, so it has no case law interpreting the fit of a demogrant into that kind of regime.

The states with flat-tax mandates, on the other hand, have never attempted to impose a demogrant, so courts have never directly addressed the question of whether such a refundable credit would meet its constitutional requirements. Courts have, however, given some hints as to how

168. *Historical U.S. Federal Income Tax Rates & Brackets, 1862–2021*, *supra* note 94.

169. Theoretically, the state could increase both the tax rate *and* the amount of the demogrant, but doing so would nonetheless change the effective tax rate of all taxpayers; some would see their taxes decrease but some would see their taxes increase.

170. Hilary W. Hoynes & Jesse Rothstein, *Universal Basic Income in the US and Advanced Countries* 18 (Nat'l Bureau of Econ. Rsch., Working Paper No. 25538, 2019), https://www.nber.org/system/files/working_papers/w25538/w25538.pdf [<https://perma.cc/M6NN-SKJA>]. The Eastern Cherokee Native American tribal government also provides members with a demogrant, funded by tribal casino revenues. *Id.*

171. Deborah Groban Olson, *Fair Exchange: Providing Citizens with Equity Managed by a Community Trust, in Return for Government Subsidies or Tax Breaks to Businesses*, 15 CORNELL J.L. & PUB. POL'Y 231, 292 (2006) (describing how a state constitutional amendment resulted in Alaska Permanent Fund's implementation).

172. ALASKA STAT. ANN. § 43.20.012(a)(1) (West 2023).

they would rule.

A. *Illinois and the Constitutionality of a Demogrant*

In Illinois, for instance, the text of the constitution, and not only its legislative history, anticipates tax credits. It expressly allows for “[e]xemptions, deductions, *credits*, refunds and other allowances,” as long as they are “reasonable.”¹⁷³ And “reasonable” does not require a credit to be available to all taxpayers on the same terms; rather, Illinois courts have found that a reasonable credit can vary depending on a taxpayer’s financial circumstances.¹⁷⁴ A demogrant—available on precisely the same terms to all taxpayers—would certainly meet the court’s definition of reasonableness.

Even if courts were to view a demogrant as materially different from the credits expressly authorized by the state constitution, they would almost certainly find that it did not violate the constitution’s mandate of nongraduated rates. The state supreme court starts with its canon of constitutional interpretation. That canon of construction provides that Illinois’s “constitution must be read and understood according to the most natural and obvious meaning of the language in order to avoid eliminating or extending its operation.”¹⁷⁵ Courts must give due deference to the state’s constitution, but must not overread it, inserting limitations that do not appear in the text.

And the text of Illinois’s constitution provides that a “tax on or measured by income shall be at a non-graduated rate.”¹⁷⁶ *Black’s Law Dictionary* defines a “graduated tax” as a tax “employing a rate schedule with higher marginal rates for larger taxable bases (income, property, transfer, etc.)”¹⁷⁷ While a flat-rate tax with a demogrant provides effective progressivity, it does not do so through marginal rates that go up as income increases. The flat tax with a demogrant would thus comply with the natural and obvious meaning of the constitutional limitation.

Illinois courts have evidenced a willingness to stick with the plain language of the constitution, including specifically with respect to limitations on the state’s taxing power. In 1979, some Illinois taxpayers challenged a revenue act that, among other things, imposed a tax on partnerships.¹⁷⁸ After prohibiting graduated rates, the Illinois constitution provides that “[a]t any one time there may be no more than one [income] tax imposed by the State for State purposes on individuals and one such

173. ILL. CONST. art. IX, § 2 (emphasis added).

174. *Toney v. Bower*, 744 N.E.2d 351, 363 (Ill. App. Ct. 2001).

175. *Maddux v. Blagojevich*, 911 N.E.2d 979, 988 (Ill. 2009).

176. ILL. CONST. art. IX, § 3(a).

177. *Tax*, BLACK’S LAW DICTIONARY (11th ed. 2019).

178. *Cont’l Ill. Nat. Bank & Tr. Co. of Chi. v. Zagel*, 401 N.E.2d 491, 500 (1979).

tax so imposed on corporations.”¹⁷⁹ The petitioners in the case claimed that by taxing the income of partnerships *in addition to* the income of partners, the new tax violated this limitation.¹⁸⁰ They argued that the plain language of the constitution meant that the state could only tax individuals and corporations, and it could only impose a single income tax on either.¹⁸¹ Taxing partnerships was not only an unauthorized move, but it imposed an unconstitutional second tax on individual income.¹⁸²

The court disagreed. It refused to strike a law down based on a “negative implication” that the statute and constitutional history did not support.¹⁸³ Overturning a flat tax with a demogrant would be similarly hard to square with the language and constitutional debates. As discussed above, the language is clear that the legislature cannot create a multiple-rate income tax, and the debates acknowledge the possibility of effective progressivity through deductions and credits.

There is another reason to believe that a demogrant would meet the constitutional requirement that the income tax have nongraduated rates: The Illinois Income Tax Act provides for a number of tax credits. These credits reduce the tax liability (and the effective tax rate) for Illinois taxpayers and have myriad purposes. They include a credit against a taxpayer’s Illinois income tax liability for investments in qualified Enterprise Zone property¹⁸⁴ and for research activities performed in Illinois.¹⁸⁵ Custodians of Illinois children can take a credit for some of their educational expenses.¹⁸⁶

These income tax credits differ in one substantial way from a demogrant: They do not reduce a taxpayer’s tax liability below \$0. But Illinois law even expressly allows for refundable tax credits. Under current law, the Illinois earned income tax credit, set at eighteen percent of the federal earned income tax credit, is fully refundable to the extent a beneficiary’s tax liability is less than the amount of the tax credit.¹⁸⁷ Just like a demogrant, the earned income tax credit causes some Illinois taxpayers to have a graduated effective state income tax rate and, in fact, provides a negative rate for the lowest-income taxpayers in the state.

These various tax credits have not been challenged on constitutional grounds,¹⁸⁸ but there is reason to believe that courts would uphold them

179. ILL. CONST. art. IX, § 3(a).

180. *Zagel*, 401 N.E.2d at 500.

181. *Id.*

182. *Id.*

183. *Id.* at 500–01.

184. 35 ILL. COMP. STAT. 5/201(f)(1).

185. *Id.* § 5/201(k).

186. *Id.* § 5/201(m).

187. *Id.* § 5/212(a),(b).

188. In general, because tax credits benefit taxpayers, taxpayers have little incentive to challenge them in court.

as constitutional. In the first instance, in Illinois “[i]t is well established that legislative enactments enjoy a heavy presumption of constitutionality.”¹⁸⁹ The law’s challenger would face the burden of “clearly establishing [the law’s] invalidity.”¹⁹⁰

While Illinois courts have not directly addressed the question of whether tax credits—and especially refundable tax credits—comply with the constitution’s nongraduated rate requirement, they have addressed the permissibility of tax credits. In 1999, for example, a group of Illinois taxpayers and parents challenged the constitutionality of a state tax credit for qualifying educational expenses.¹⁹¹ They claimed, among other things, that the credit was essentially unavailable to the parents of students attending public schools, that it was unavailable to low-income families, and that it subsidized religious schools, all in violation of the state constitution.¹⁹² The court upheld the credit’s constitutionality (albeit without addressing the question of a nongraduated tax, which the parties did not raise).¹⁹³

B. Demogrants in Other State Constitutional Regimes

While this Article has largely focused on the permissibility of a demogrant in Illinois’s flat-rate tax regime, neither the prohibitions on progressive marginal rates in a state’s income tax nor benefits of a flat tax with a demogrant are limited to Illinois. Massachusetts’s constitution, for example, requires the state to levy its income tax “at a uniform rate throughout the commonwealth upon incomes derived from the same class of property.”¹⁹⁴ At the same time, the constitution allows “reasonable exemptions and abatements” from the income tax.¹⁹⁵

The Supreme Judicial Court of Massachusetts has interpreted “reasonable exemptions and abatements” to include deductions, credits, and any other provision favorable to taxpayers.¹⁹⁶ And, unlike Illinois, Massachusetts courts have expressly addressed the question of whether tax credits qualify under the state’s constitutional limitations. In 1930, the Supreme Judicial Court upheld the constitutionality of personal exemptions and credits included in a state income tax bill.¹⁹⁷ The only limit on the legislature’s power to grant these exemptions and credits was that any credit or exemption must be “reasonable.”¹⁹⁸ And, similar to in Illinois, this

189. *In re Marriage of Lappe*, 680 N.E.2d 380, 384 (Ill. 1997).

190. *Id.*

191. *Toney v. Bower*, 744 N.E.2d 351, 355–56 (Ill App. Ct. 2001).

192. *Id.*

193. *Id.* at 361.

194. MASS. CONST. art. XLIV.

195. *Id.*

196. *Massachusetts Tchrs. Ass’n v. Sec’y of Com.*, 424 N.E.2d 469, 487 n.27 (Mass. 1981).

197. *In re Opinion of the Justs.*, 170 N.E. 800, 803 (Mass. 1930).

198. *Id.* at 802.

reasonableness analysis essentially looks to ensure that the burden of government falls “as nearly equally as possible among those able to bear them.”¹⁹⁹ Because the purpose of a demogrant is to reduce the regressivity of state tax regimes, it would meet this type of reasonableness requirement.

Michigan’s constitution also mandates a flat income tax. The constitution does so by prohibiting any “income tax graduated as to rate or base.”²⁰⁰ As a result of the constitutional mandate, Michigan imposes an individual income tax with a flat 4.25 percent rate.²⁰¹ But like Massachusetts and Illinois, Michigan tax law allows for a personal exemption (in Michigan, of \$3,700 per person).²⁰² This kind of personal exemption provides a degree of progressivity in the tax law, in spite of its flat rate.²⁰³

In addition, as in Illinois, Michigan tax law provides for an earned income tax credit equal to six percent of the federal earned income tax credit.²⁰⁴ And, as with Illinois, if the credit exceeds a taxpayer’s tax liability, the state pays the taxpayer the excess amount.²⁰⁵ The legislature, then, is comfortable that the state constitution permits a refundable tax credit, which not only creates progressive effective rates but, under some circumstances, creates a negative tax rate in precisely the same manner as a demogrant would.

Moreover, in the 1970s, Michigan taxpayers challenged the constitutionality of its tax system, in part based on the idea that the law’s provision of tax exclusions and credits violated the prohibition on graduated rates.²⁰⁶ The state supreme court disagreed; it believed that the constitution’s limitation was meant solely to prevent a system like the federal income tax where “rates increase as taxable income does.”²⁰⁷ The effective progressivity of allowing tax credits, by contrast, was entirely compatible with the state’s constitution.²⁰⁸

Finally, Pennsylvania’s constitution requires that taxation be “uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax”²⁰⁹ Taxpayers currently owe taxes at a 3.07 percent rate.²¹⁰ Unlike other states with constitutional prohibitions on graduated rates, Pennsylvania taxpayers cannot reduce their tax liability

199. *Id.* at 802–03.

200. MICH. CONST. art. IX, § 7.

201. MICH. COMP. LAWS ANN. § 206.51(1)(b) (West 2020).

202. *Id.* § 206.30(2).

203. *See generally supra* notes 120–128 and accompanying text.

204. MICH. COMP. LAWS ANN. § 206.272(1)(c) (West 2022).

205. *Id.* § 206.272(2).

206. *Kuhn v. Dep’t of Treasury*, 183 N.W.2d 796, 801 (Mich. 1971).

207. *Id.*

208. *Id.*

209. PA. CONST. art. VIII, § 1.

210. 72 PA. Stat. and Cons. Stat. § 7302(a) (West 2003).

through personal exemptions or a standard deduction.²¹¹ In addition, the state limits credits against tax largely to taxes withheld against Pennsylvania taxes and those paid by Pennsylvania taxpayers to other states.²¹²

The fact that Pennsylvania largely disallows credits does not mean, however, that it entirely disallows them. The state's tax law has a special rule for certain low-income taxpayers. If a Pennsylvania taxpayer's income does not exceed a certain threshold, the taxpayer gets a tax credit equal to their tax liability.²¹³ The credit phases out as income increases and is completely phased out when a taxpayer's income exceeds the statutory poverty level by more than \$2,500.²¹⁴

As part of the tax statute, the legislature explained that it created this special tax credit under a constitutional provision allowing an exemption to its uniformity requirement.²¹⁵ Pennsylvania's constitution grants the legislature the authority to establish special classes of taxpayers "who, because of age, disability, infirmity or poverty are determined to be in need of tax exemption or of special tax provisions"²¹⁶ As long as that class is treated uniformly, the legislature can create a different set of taxes than those that apply to the general class of taxpayers.²¹⁷

The legislature may have made explicit its constitutional authority to create poverty-related exemptions because Pennsylvania courts have been hostile to any variation from uniform taxation. In 1935, the state supreme court struck down a provision that would have exempted from taxation individuals earning less than \$1,000 or married couples earning less than \$1,500.²¹⁸ The court found that by treating lower-income individuals differently from higher-income individuals, the tax law "plainly and without question violates the constitutional rule regarding uniformity"²¹⁹ Moreover, the court said, the people of Pennsylvania had demonstrated their hostility to progressive taxation by twice rejecting proposed constitutional amendments that would have permitted graduated rates.²²⁰

Unlike the other three states with constitutionally mandated flat taxes, then, it is not clear that Pennsylvania courts would uphold a flat tax with

211. *Personal Income Tax*, PA. DEP'T OF REVENUE, <https://www.revenue.pa.gov/Tax-Types/PIT/Pages/default.aspx> (last visited May 3, 2022) [<https://perma.cc/P6PB-JTDU>].

212. 72 PA. Stat. and Cons. Stat. § 7312 (West 2017); 72 PA. Stat. and Cons. Stat. § 7314 (West 2013).

213. *Id.* § 7304(d)(1). The poverty-level income to which this provision applies is \$6,500 for an unmarried taxpayer and \$13,000 for married taxpayers. *Id.* In addition, the law allows an additional \$9,500 of income per dependent. *Id.*

214. *Id.* § 7304(d)(2)(ix).

215. *Id.* § 7304(a).

216. PA. CONST. art. VIII, § 2(b)(ii).

217. *Id.*

218. *Kelley v. Kalodner*, 181 A. 598, 602 (1935).

219. *Id.* at 603.

220. *Id.*

a demogrant. But it is possible, and perhaps likely, that they would. After all, the demogrant differs materially from the provision that the state supreme court disallowed in the early twentieth century. That provision created an explicit exemption that only applied to low-income individuals. A demogrant, by contrast, would represent a credit available to all taxpayers. While it would create effective progressivity, it would also be uniform, not varying based on a taxpayer's level of income. That would appear to comply with the text of the state constitution.

C. Demogrants Beyond Flat-Tax States

While this Article has focused on a flat tax with a demogrant as a solution to regressivity in states that have a constitutional prohibition on graduated rates, there is no reason why such a tax regime should be limited to those states. Any state that can impose an income tax could use a demogrant, rather than progressive marginal rates, to create progressivity.

In fact, shifting to a demogrant would be beneficial for these states. While marginal tax rates can create progressivity, they do so with costs. Progressive marginal tax rates lead to complexity and economic waste.²²¹ And even at the state level, increasing marginal tax rates can discourage work. At the very least, economists generally believe that as marginal tax rates increase, states see welfare losses as taxpayers engage in tax-avoidance behaviors.²²² A demogrant, by contrast, means that at no point does an additional dollar of income face a higher tax rate. As income increases, the applicable tax rate stays the same.

Because a demogrant is refundable, it also offers a mechanism with which state governments can provide welfare benefits to their citizens in an efficient manner.²²³ Not only are tax credits more efficient than deductions (which disproportionately benefit high-income taxpayers), but they can protect low-income families from unexpected fluctuations in income.²²⁴

While many policymakers see welfare spending through refundable credits as a "social policy magic bullet,"²²⁵ a demogrant could not replace all state welfare spending. While refundable tax credits are generally efficient, they only provide recipients with cash. They do not address

221. Edward J. McCaffery & James R. Hines Jr., *The Last Best Hope for Progressivity in Tax*, 83 S. CAL. L. REV. 1031, 1089–90 (2010).

222. Daniel Shaviro, *The Minimum Wage, the Earned Income Tax Credit, and Optimal Subsidy Policy*, 64 U. CHI. L. REV. 405, 421 (1997).

223. See Batchelder et al., *supra* note 139, at 24 (arguing that uniform refundable tax credits increase efficiency and incentivize socially valued behavior).

224. *Id.* at 29.

225. Dennis J. Ventry, Jr., *Welfare by Any Other Name: Tax Transfers and the EITC*, 56 AM. U. L. REV. 1261, 1261 (2007).

underlying systemic causes of poverty.²²⁶

Still, as part of an overall welfare system, a demogrant would provide states with a fairly efficient means to make cash transfers to individuals and families in need. It would also provide for a similarly efficient redistribution that ameliorated the welfare losses of marginal tax rates.

Still, most states have a century or more of experience with income taxation, and none have enacted an income tax with a demogrant. For politicians, inertia is an extremely attractive tax strategy.²²⁷ Enacting tax legislation is salient to taxpayers, who are likely to notice and care when their taxes increase.²²⁸ As a result, politicians often do not want to risk being associated with increasing constituents' taxes.²²⁹ The easiest thing, then, is to maintain the status quo.²³⁰

In theory, federalism is supposed to overcome this inertia in the United States. States are popularly celebrated as "laboratories of democracy," places that can incubate and spread innovation.²³¹ There are, however, reasons to be skeptical that they actually function as laboratories on a regular basis.²³² Because of the relative ease of other states' adopting innovations and the limited gains of being the first mover, states will generally not have incentive to innovate.²³³

A combination of the political benefits of inertia and the limited gains associated with innovation mean that most states have no incentive to shift from a tax regime with graduated marginal tax rates to a flat tax with a demogrant. After all, even if their current tax systems are inefficient, they are already known quantity. More than that, they are generally accepted. For all its imperfections, a flat-tax system raises revenue and provides marginal progressivity (or, at least, reduces the overall regressivity of the tax regime).

But that calculus is different for the four states with a constitutionally mandated flat tax. As Illinois's experience demonstrates, constitutional

226. See Marjorie E. Kornhauser, *Cognitive Theory and the Delivery of Welfare Benefits*, 40 LOY. U. CHI. L.J. 253, 256 (2009). Professor Kornhauser also pointed out that refundable tax credits are not entirely efficient: phaseouts create disincentives to work. *Id.* A demogrant would not create that work disincentive, though, as it does not phase out: all taxpayers get the benefit of the demogrant.

227. See Lawrence Zelenak, *Taking Critical Tax Theory Seriously*, 76 N.C. L. REV. 1521, 1567 (1998) ("One may have strong arguments that a provision of the tax laws is wrong, yet find that those arguments are insufficient to overcome legislative inertia.").

228. RICHARD ROSE & TERENCE KARRAN, *TAXATION BY POLITICAL INERTIA: FINANCING THE GROWTH OF GOVERNMENT IN BRITAIN* 4 (1987).

229. *Id.* at 4–5.

230. *Id.*

231. Hannah J. Wiseman & Dave Owen, *Federal Laboratories of Democracy*, 52 U.C. DAVIS L. REV. 1119, 1121 (2018).

232. *Id.*

233. Brian Galle & Joseph Leahy, *Laboratories of Democracy? Policy Innovation in Decentralized Governments*, 58 EMORY L.J. 1333, 1370 (2009).

limitations effectively create a lock-in; even where a substantial portion of the electorate would prefer something different (in this case, a progressive income tax), the supermajority required to change the constitution makes that less likely.

For these four states to enact a progressive income tax, then, they cannot rely on inertia, and they cannot adopt the generally accepted form of progressivity, with its increasing marginal tax rates. Rather, if they want to create a progressive tax system, they must innovate. While adding a demogrant to their flat taxes may not be politically costless, it is a constitutionally permissible way to improve the progressivity of the states' overall tax regimes. Moreover, it does so in a way that does not require supermajority votes. And if it proves a successful experiment in one or more of these states, it may provide incentive for other states—and perhaps even the federal government—to shift to a more efficient form of progressivity.

VI. CONCLUSION

State and local tax regimes, which rely largely on regressive forms of taxation, unsurprisingly tend to be regressive themselves. That regressivity means that poorer and minoritized state residents tend to pay more as a percentage of their income for state services than higher-income residents. And if they and high-income residents do not pay enough, they are left with reduced services, a burden that also falls harder on the poor than on the rich.

To the extent that states ameliorate this regressivity, they tend to do so through the imposition of a progressive income tax. But even among the majority of states that have a personal income tax, that tax does little to affect the overall mix of regressive taxes. Most states with progressive income taxes have limited progressivity in their income taxes, and that limited progressivity does little to deal with income inequality or the state's other regressive taxes.²³⁴

This regressivity is worse in states without income taxes and with flat (or relatively flat) income taxes. And four states with a flat-rate income tax face the dead-hand control of earlier drafters of their state constitutions. In these four states, the legislative hurdle to creating progressive marginal rates is, while not impossible to overcome, at least significantly difficult.

This Article provided those states with a blueprint they can use—consistent with constitutional limits on multiple marginal rates—to create a

234. See DYLAN GRUNDMAN, INST. ON TAX'N & ECON. POL'Y, MOVING TOWARD MORE EQUITABLE STATE TAX SYSTEMS, 2–3 (2019), https://itep.sfo2.digitaloceanspaces.com/Moving-Toward-More-Equitable-State-Tax-Systems_Grundman.pdf [<https://perma.cc/A5TJ-XPW3>] (criticizing most states' income tax schemes for largely failing to meaningfully address inequality).

progressive income tax that counteracts the regressivity of their property and sales taxes. An income tax with a flat rate and a universal refundable credit, available to all taxpayers, creates a truly progressive tax rate. It is consistent with state tax provisions that have been blessed both by lawmakers and courts in the various states with constitutional prohibitions on marginal progressivity. And, in fact, a flat tax with a demogrant is more efficient than an income tax with progressive marginal rates.

While there has been some political resistance to demogrant over the past several decades, that resistance appears to have occurred primarily at the federal level. And the assumption underlying it—that the government should not give cash aid to people because it might discourage work—has been undermined both by the earned income tax credit and the increasing popularity of universal basic income.

Of course, a flat-rate tax with a demogrant may not solve all the problems of regressivity. In this case, though, the four states with a constitutionally mandated flat-rate income tax are perfect laboratories of democracy. Most states do not need to innovate—they already have (or have the ability to enact) a progressive income tax using increasing marginal tax rates. These four states, though, cannot freeride on that standard approach. Instead, they must innovate.

Moreover, to the extent this innovation proves successful, other states could shift their tax systems to adopt a flat tax with a demogrant. Critically, though, decreasing the regressivity of state tax systems is a pressing need, and in Illinois, Massachusetts,²³⁵ Michigan, and Pennsylvania, far from being a bargain-basement solution, a demogrant may be the best way to accomplish this goal.

235. Massachusetts may achieve the difficult task of amending its constitution to remove the prohibition on progressive rates. The state legislature has approved the change, and in November 2022, voters will decide whether to approve it. Matt Murphy, *A “Millionaires Tax” in Mass. Would Net \$1.3 Billion in Revenue, Report Finds*, WBUR (Jan. 13, 2022), <https://www.wbur.org/news/2022/01/13/millionaires-tax-report-massachusetts> [<https://perma.cc/AYX7-G23U>]. As Illinois learned, however, the legislature approving such a change is not a guarantee that the voters will follow. *See supra* note 57 and accompanying text.