



State and Local Taxes in Illinois: Issues and Trends

Blackhawk Hills
Regional Council

April 24, 2015

Taxpayers' Federation of Illinois

- Since 1940, Illinois' premier government watchdog organization
- Advocates sound and balanced tax and spending policies for Illinois' state and local governments
- Membership: businesses, tax professionals, individuals, local governments, other organizations
- Recent research topics:
 - Why so many corporations pay \$0 income tax
 - Homestead exemptions
 - Taxation of retirement income
 - Coming soon: assessment quality



TAX FACTS



Taxpayers' Federation of Illinois

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The Seven Percent Solution Falls Victim to the Real Estate Crash

By Sonia Vasdev and Mike Klemens

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Mike Klemens who retired last year as Manager of Policy and Communications with the Illinois Department of Revenue, does tax policy research for the Taxpayers' Federation of Illinois.

Cook County homeowners are seeing their property values go down and their tax bills go up – the latest twist in the complex and confusing world of Cook County property taxation.

To a Cook County homeowner the result is shocking. Homeowners are seeing an unprecedented decline in the value of their homes – a loss over which they have no control and which affects the financial future of many. At the same time homeowners are seeing large increases in the amount of their property tax bill.

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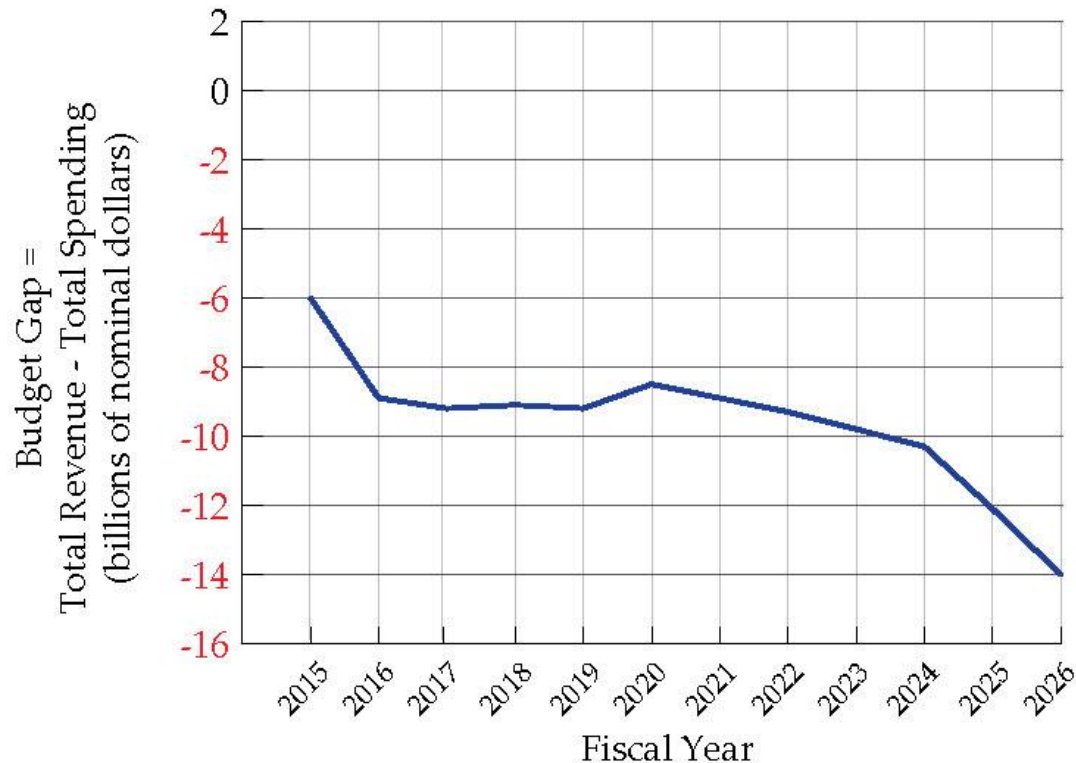
The State of Our State

- **Backlog of Unpaid Bills:** \$5.0 Billion
As of 4/16/2015. **PLUS** \$2.2 Billion “in the system”
- **Unemployment Rate:** 6.0%
February 2015 (US: 5.5%; IL in December 2014: 7.9%)
- **Bond Rating:** A-/A3
- **Schools in Deficit Spending:** 42.3%
FY 2014. 2015 Projections: 64.2%
- **Business Capital Projects in 2014:** 394
3rd highest in US; 8th highest per capita (Site Selection Magazine)



Depressing Chart-of-the-Day

Illinois All-Funds Budget Gap Projections for FY 2015 - 2026



Source: "Apocalypse Now? The Consequences of Pay-Later Budgeting in Illinois: Updated Projections From IGPA's Fiscal Futures Model;" University of Illinois, Institute on Government and Public Affairs, Fiscal Futures Project, January 2015



How to Fill a \$6 Billion Hole?

(Or \$1.5 Billion, or \$9 Billion)

- Increase Revenue
- Cut Spending
- Magic



Option One: Raise Taxes

Previous revenue-raising suggestions:

- Reinstate income tax rates (\$4 - \$6 Billion)
- Expand sales tax base to include services (\$2 Billion)
- Tax retirement income (\$2.2 Billion)
- Tax groceries (\$1.6 Billion)
- Targeted tax increases on business (varies, but typically < \$100 million)



Isn't Illinois already a high tax state?

- The answer is in the eye of the beholder
- Our 2011 – 2014 individual income tax rate: 5% (now: 3.75%)
- Other states' maximum rates:

Indiana	3.4%	Iowa	8.98%
Wisconsin	7.65%	California	12.3%
New York	8.82%	Pennsylvania	3.07%
Florida	0%	Michigan	4.25%

Source: Federation of Tax Administrators



TFI Tax Burden Analysis--FY2012

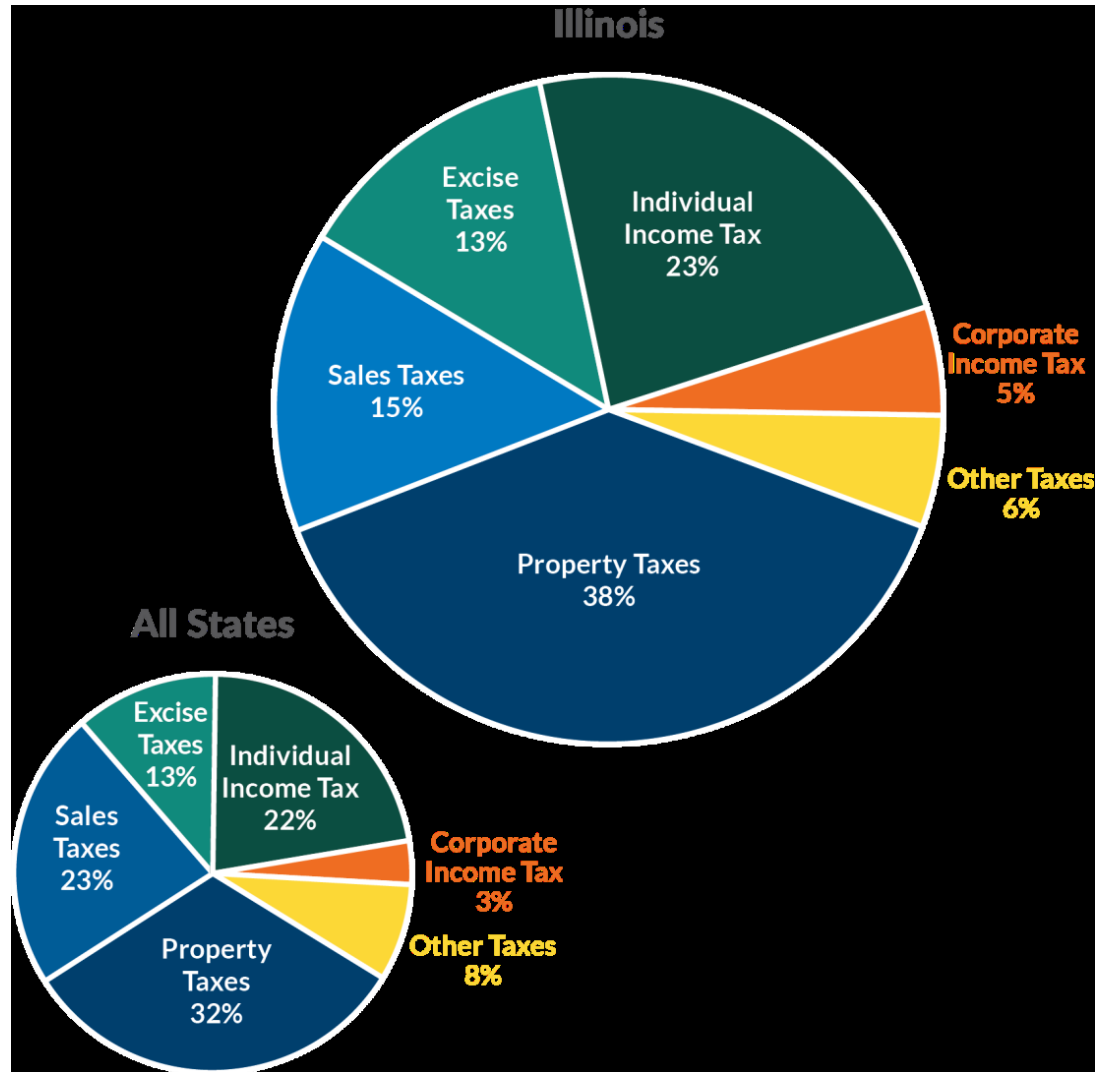
Total state and local tax burden as a % of state GDP (estimating the full effect of the tax rate hike):

Midwest States	Ranking—State and Local Taxes as a % of State GDP
Wisconsin	9
Illinois	15
Michigan	19
Ohio	22
Iowa	28
Indiana	34
Missouri	38

Sources: Census Bureau and Bureau of Economic Analysis



Sources of State and Local Tax Revenue



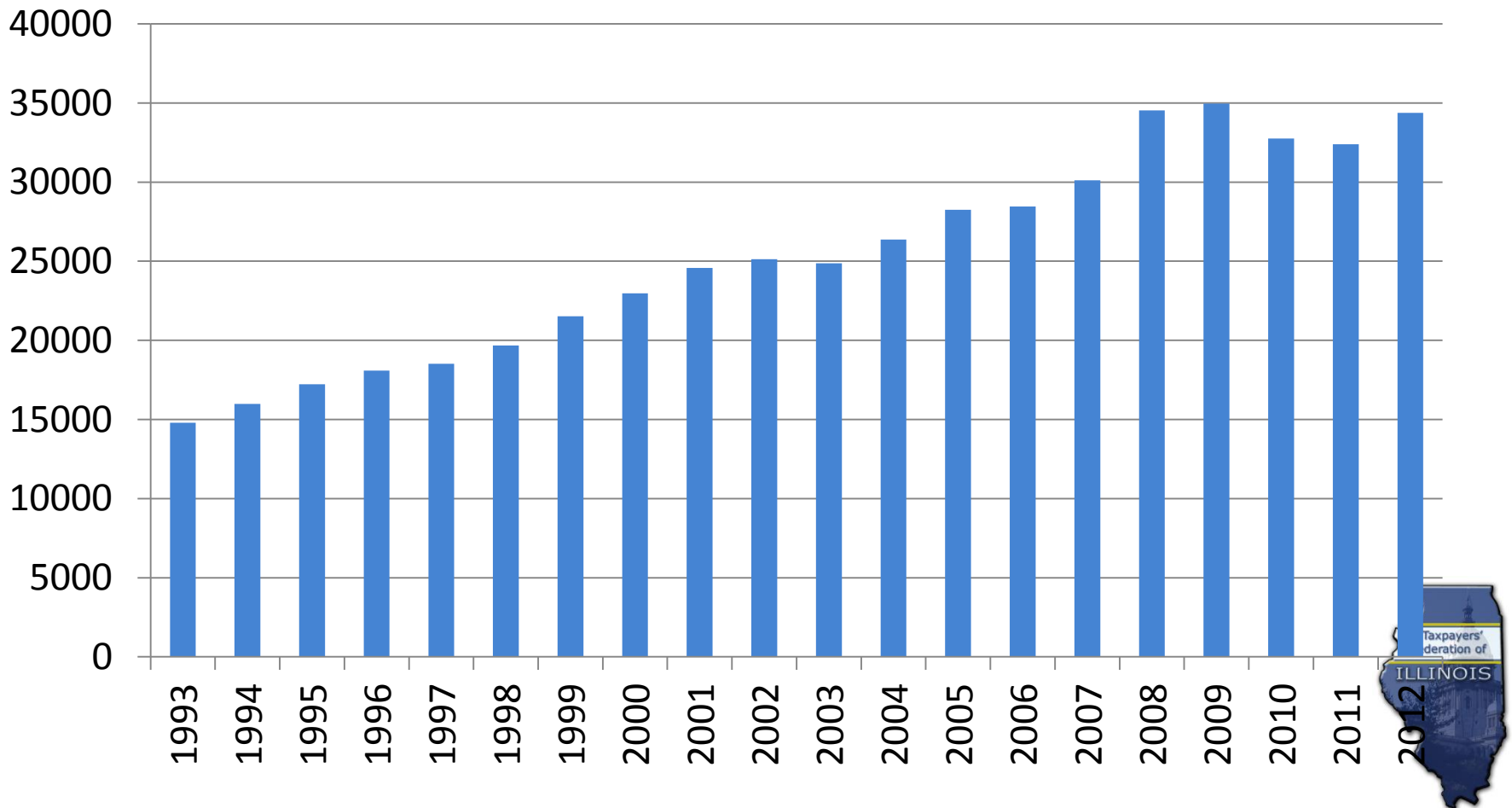
Source: Tax Foundation calculations; Census Bureau 2012



Option Two: Cut Spending

Historic Spending in Illinois

General Funds, in thousands



More Statistical History, 1993 - 2012

State-wide increases over the 20-year period:

- General Funds Spending Growth: 133%
- All funds spending: 146%
- Inflation (the Consumer Price Index): 59%
- State Gross Domestic Product: 117%



Option Three in Action: The saga of the FY 2015 Budget

Governor Quinn's proposed budget:

- “Recommended” numbers based on maintaining tax rates
- “Not Recommended” doom and gloom numbers based on then-current law (>\$2.5 billion in cuts)

House voted on 3 sets of budget bills:

- 1) Appropriating funds assuming tax rates stay up
70+ bills passed House but not sent to Senate
- 2) Draconian cuts based on original revenue projections
Received only 5 “aye” votes in House
- 3) Middle ground—have your cake and eat it, too

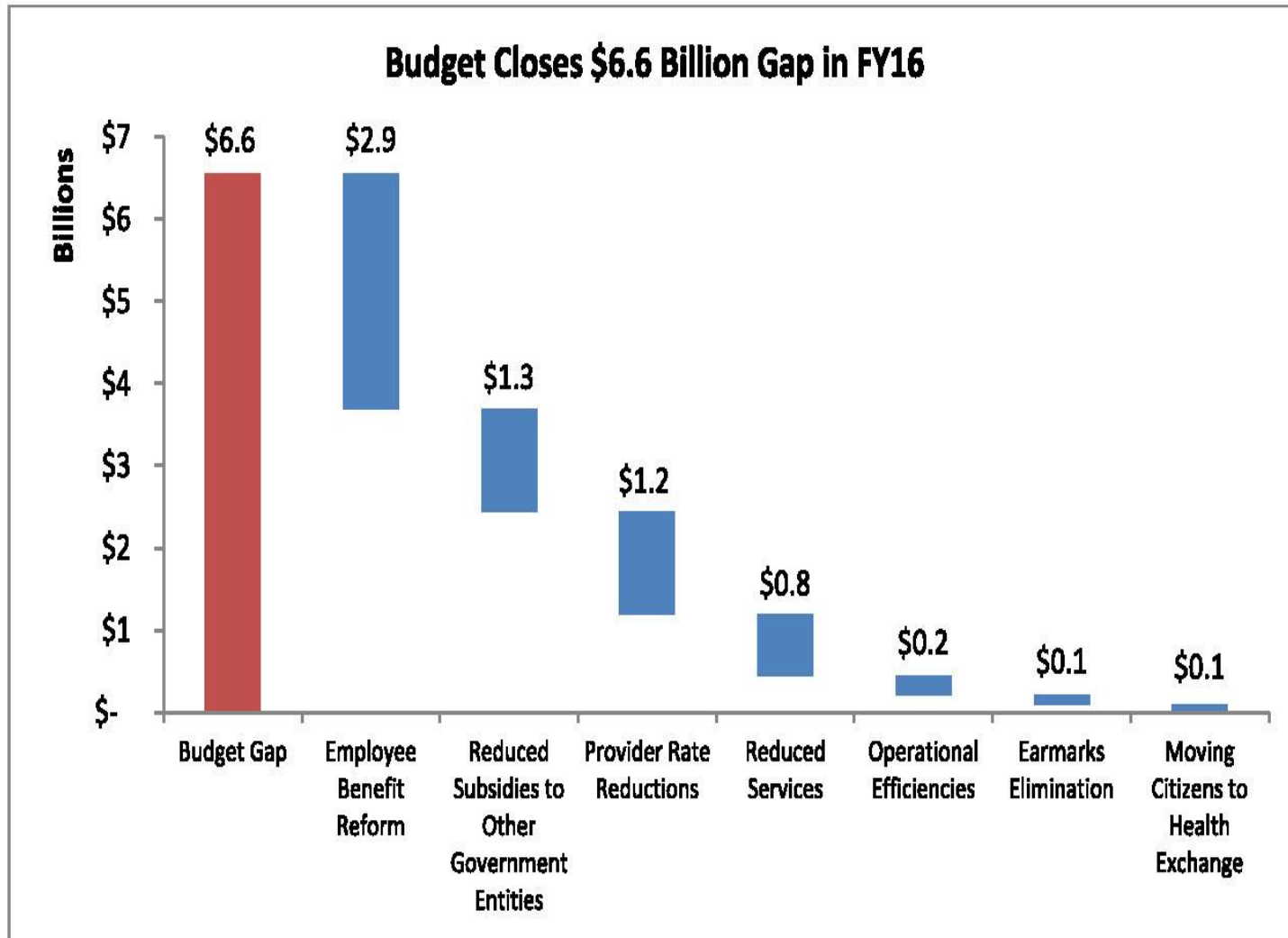


Fiscal Year 2015

- Appropriated Spending: \$35.35 Billion in General Funds; \$69.8 billion total
- Included one-time shifting and borrowing
- Estimated shortfall: \$1.6 Billion
- Solution: one-time fund transfers (\$1.3 Billion); spending cuts (2.25% across-the-board); Governor can tap into some discretionary funds (\$187 million)



Governor's Proposed 2016 Budget



Source: Governor's Office of the Budget, 2016 Proposed Budget Operating Book



What's Next?

- FY 2016 begins July 1, 2015
- Bills passed after May 31 require 3/5 majority
- Governor says will NOT consider revenue proposals until/unless other reforms are addressed
- He has mentioned:
 - unemployment insurance reform
 - lawsuit reform
 - local control over collective bargaining
 - municipal bankruptcy
 - term limits
 - merge comptroller and treasurer
 - ban union campaign contributions
 - revolving door for senior members of the administration
 - pension constitutional amendment
 - local government consolidation



And there are other issues...

- Pensions—State AND Local
- AFSCME Contract
- Capital Bill
- Gaming
- Telecom and Electricity Industry Initiatives



Possible Major Tax Issues in 2015

- Property Taxes (Freeze—PTELL?)
- Sales Taxes (services, sourcing, food, internet purchases, sweetened beverages, diapers)
- Income Taxes (rates, retirement income, EDGE credit and other “loopholes”)



How many bills?

House Bills	4200
House Resolutions	358
House Joint Resolutions	65
House Joint Resolution Constitutional Amendments	35
Senate Bills	2129
Senate Resolutions	319
Senate Joint Resolutions	20
Senate Joint Resolution Constitutional Amendments	13



How Many Bills Do We Care About?

Number of Bills Being Tracked
276 House Bills
103 Senate Bills
20 Other Types of Legislation

What Kind of Bills?

114 Income Tax Bills
111 Property Tax Bills
45 Sales Tax Bills
109 Other Bills
118 Revenue Shell Bills



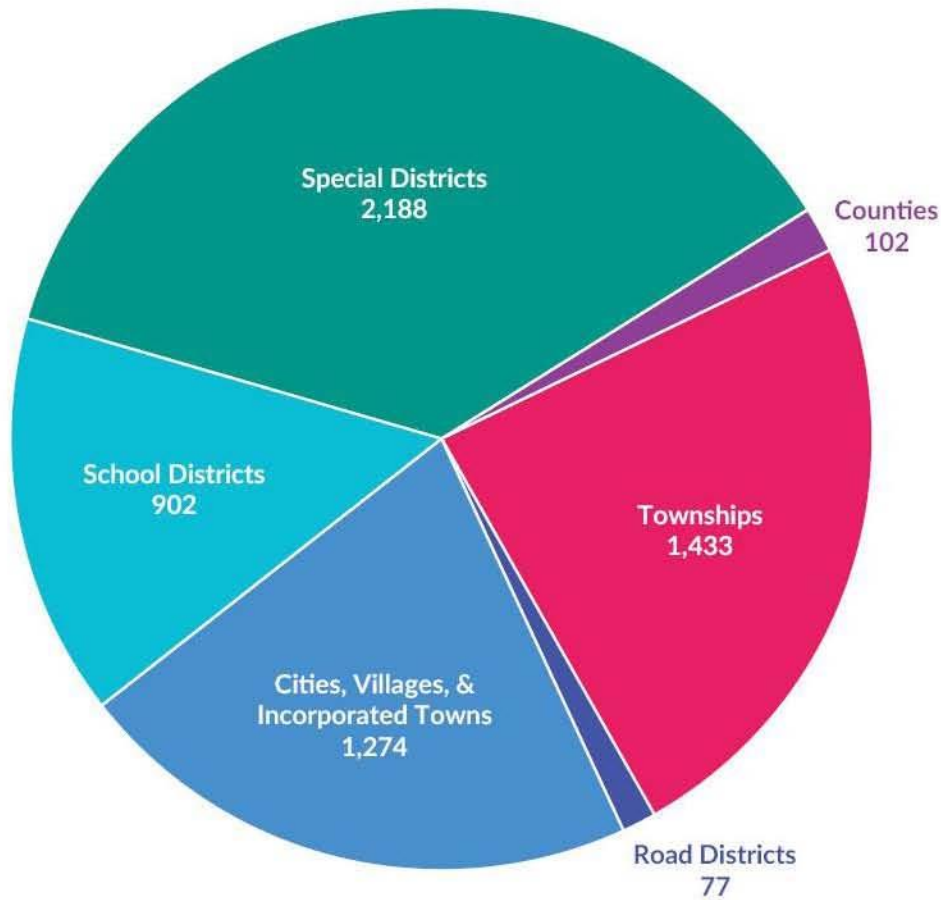
Property Tax

- The least popular tax
- Governor Rauner has suggested freezing property taxes unless voters approve an increase
- What does that mean?
 - Probably *not* an actual freeze of each land-owner's tax bill
 - Some think it's an expansion of PTELL



Illinois Had 5,976 Different Taxing Districts in 2012

Percent of Total Number of Taxing Districts by Type (2012)



Source: Illinois Department of Revenue.

About those “special” units...

Fire protection	838	Soil & Water conservation	8
Park	361	Conservation	5
Sanitary	99	Auditorium authority	1
Forest preserve	14	Mass transit	7
Mosquito abatement	22	Watershed/flood control	4
Public health	4	Multi-twp. assessment	327
TB sanitarium	---	Water service	1
Airport authority	28	Museum district	3
Library	349	Solid waste disposal	5
Hospital	15	Rescue squad	4
Street lighting	26	Public water district	---
River conservancy	13		
Water authority	16		
Surface water protection	6		
Cemetery	31		

Source: Illinois Department of Revenue, Property Tax Statistics 2012, Table 4



PTELL—what is it?

- Property Tax Extension Limitation Law (or “tax caps”)
- PTELL’s goals:
 - 1) protect property owners from increased taxes, while
 - 2) recognizing that taxing districts need *some* increased revenues
- PTELL limits the increase in total taxes collected to the rate of inflation.
- Taxing districts can exceed the inflationary increase only with the permission of voters.
- PTELL does not cap individual tax bills; it does slow the growth of tax bills, particularly when property values are increasing



PTELL--History

- **1991:** imposed on the collar counties (DuPage, Kane, Lake, McHenry and Will counties)
- **1994:** imposed on Cook County
- **1996:** downstate county boards were given the authority to put the question on the ballot and ask voters whether the county should be covered by PTELL
- To date voters in 33 counties have approved PTELL; voters in nine counties have rejected PTELL.



PTELL –How does it work?

1. The Department of Revenue publishes the annual change in the Consumer Price Index for all urban consumers.

2013 change, to be used in 2014 calculations (payable in 2015) is 1.5 %

2. PTELL Districts are limited to a tax rate that would generate an increase in taxes payable equal to the lesser of 5 percent or the CPI change, when applied to the previous year's property base (the "limiting rate").
3. The limiting rate is then applied to the current year's property base (including new property).



PTELL—an example

- School District Y, in a PTELL county:
- Year One tax extension: \$10,000,000
- Year One EAV: \$100,000,000
- Year One tax rate: 0.10, or 10%

- Assume this year's EAV: \$105,000,000
- Lesser of 1.5% or 5% times \$10 million =
- This year's permissible increase in taxes: \$150,000
- To collect \$10,150,000 on \$105,000,000 base: 0.0967, or 9.67% is the highest permissible (“limiting”) rate



PTELL—more complications

Exclusions:

- PTELL does not apply to all funds – particularly not to certain debt service funds.
- Home rule districts within PTELL counties are exempt
- Districts crossing county lines

Calculation complexities:

- New property (construction) is not taken into consideration when calculating the limiting rate
- Expiring TIFs are treated like new property



PTELL—Does it work?

- Districts are limited in the amount of tax they can levy
- But, homeowners can still see increases in tax bills—PTELL is not really a tax “cap”
- Everyone hates it--maybe that means it is working!
- Expert opinions vary as to whether increases would have occurred without PTELL



PTELL—use it or lose it

- Assume a PTELL-limited taxing jurisdiction with no EAV growth, but 5% CPI, so extensions can grow by 5% each year
- In Year 3, they opt not to increase the extension the full amount
- Future extensions are unable to make up that lost difference:

Tax Year	Extension Growth at 5%	Actual Extensions	Lost \$
1	\$12,000,000	\$12,000,000	
2	\$12,600,000	\$12,600,000	
3	\$13,230,000	\$13,000,000	\$230,000
4	\$13,891,500	\$13,650,000	\$241,500
5	\$14,586,075	\$14,332,500	\$253,575
6	\$15,315,379	\$15,049,125	\$266,254
7	\$16,081,148	\$15,801,581	\$279,566



Top 10 County Revenue Sources

Moultrie County	
Property Tax	29.96%
State Sales Tax	15.63%
Other	13.49%
Streets and Highways	11.96%
State Income Tax	7.39%
State Motor Fuel Tax	5.14%
Fines and Forfeitures	3.87%
General Support	3.59%
Miscellaneous	3.02%
Health and/or Hospitals	1.79%
Total Top 10	95.24%

Macon County	
Property Tax	29.26%
Fines and Forfeitures	11.16%
State Sales Tax	9.13%
Health and/or Hospitals	8.06%
Public Welfare	7.78%
Other	6.66%
Miscellaneous	6.29%
Other Intergovernmental	5.33%
State Motor Fuel Tax	3.53%
Public Welfare	3.19%
Total Top 10	90.39%

DuPage County	
Local Sales Tax	19.37%
Other (Explain)	17.51%
Property Tax	16.07%
State Motor Fuel Tax	8.19%
Fines and Forfeitures	7.97%
Licenses and Permits	4.71%
Public Welfare	4.10%
Sewer Utilities	3.33%
Other (Explain)	3.18%
Miscellaneous (Explain)	2.89%
Total Top 10	87.32%



Source: Illinois Comptroller's Local Government Warehouse; data as of 8/5/2014

Sales Tax Issues to Watch

- Remote (online) sales
- Sourcing
- Taxing food
- Taxing services



Sales Tax Revenues

State-Level Retailers Occupation Tax: 6.25%

- 5% “state rate”
- 1% municipal tax (or county, if unincorporated)
- 0.25% county tax

FY 2012:

- Counties’ share of the 1%: \$48.9 million.
- 0.25 % county tax: \$213.0 million.

State-Level Use Tax: 6.25%

- 5% state rate
- 1.25% local tax—some is allocated to counties, based on population

FY 2012: counties received \$24.9 million

County Retailers’ Occupation Tax

- Requires voter approval
- Public safety or transportation use only

FY 2012: 35 counties imposed the tax, generating \$86.6 million.



Taxing Online Sales

- TAX IS DUE!
- *Quill v. North Dakota* (US 1992): catalog and online sellers don't have to collect tax without a physical presence in state
- Customers owe tax, but seldom pay (5% in IL in 2011)
- Competitive disadvantage to brick-and-mortar retailers
- Lost tax \$ (\$170 - \$250 million/year)
- Federal and state efforts to level the playing field—so far, with limited success (Amazon started 2/1/2015)



Local Sales Tax Sourcing

- Where did a sale occur?
- Easy with over-the-counter; not so easy in complicated transactions
- Lawsuits by DOR, RTA, others, challenging status quo
- *Hartney Fuel Oil Co v. Hamer*, 2013 IL 115130 (11/21/2013)
- New regulations in 2014 (<http://www.revenue.state.il.us/News/HartneyDecision.htm>) ; possibly new laws (HB 3110, SB 1548)



Taxing Food?

- Illinois, like most states, exempts groceries from state-level tax
- Local 1% (or more) still applies
- 2013 cost: \$1 Billion
- Food stamp/SNAP/WIC purchases are always exempt

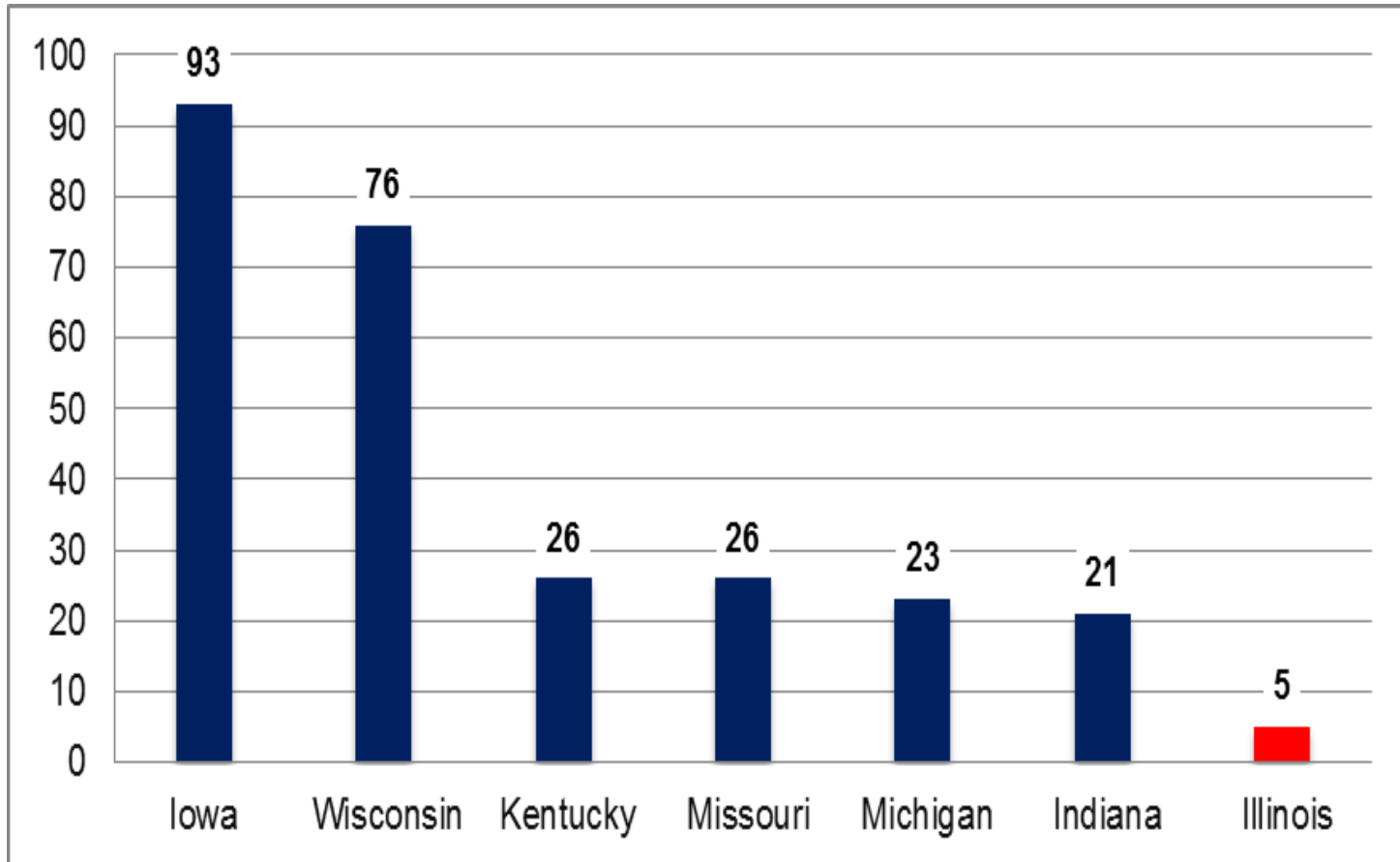


“Service” Tax

- Not a completely new tax regime, but really expanding the current sales tax regime to services
- List taxed services v. list exempted services
- Special rates?
- Pros:
 - Additional revenue
 - Fairness and stability
 - Grows with economy
- Cons:
 - Tax pyramiding if B-to-B transactions are taxed
 - Complicated
 - Politics



Number of Service Industries Taxed under General Sales Tax

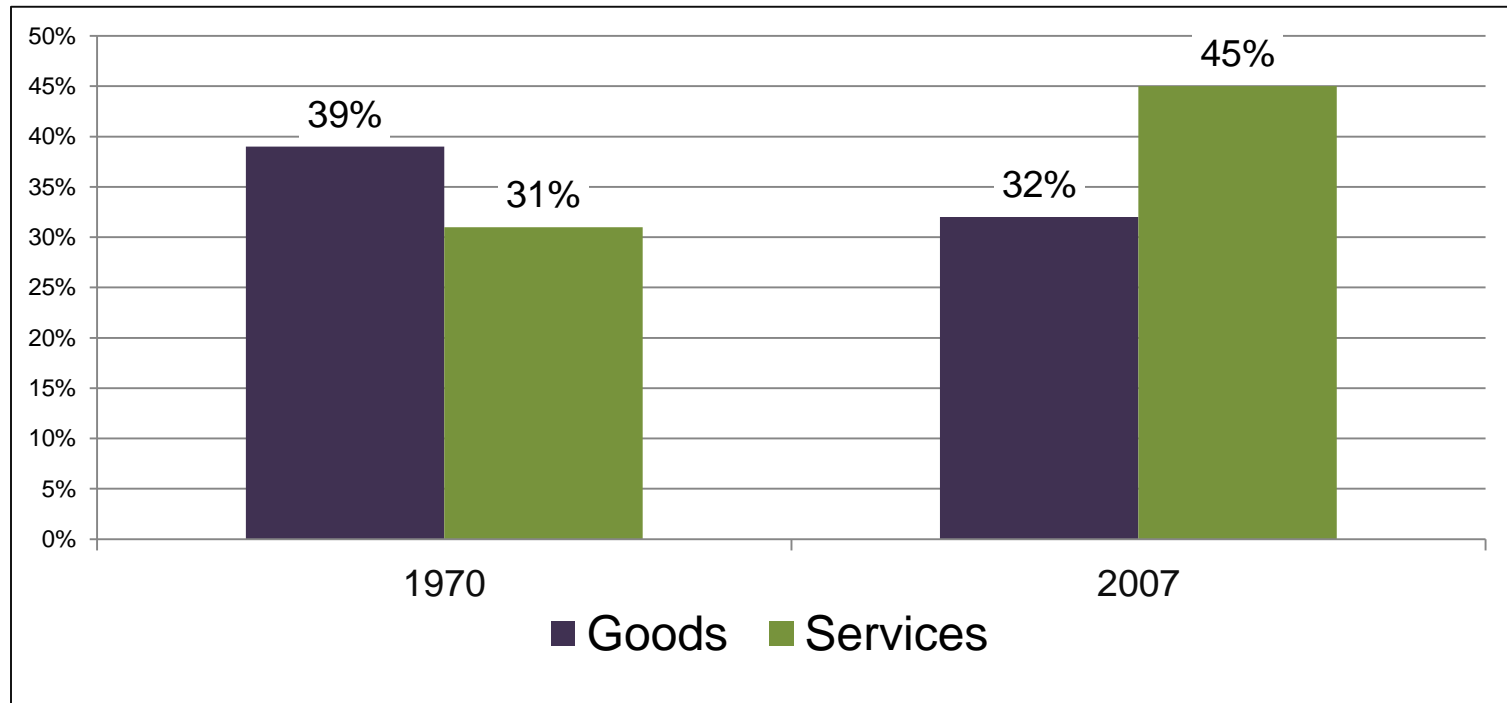


Source: Analysis of Federation of Tax Administrators, Survey of Services Taxation (Washington, DC: July 2008), <http://www.taxadmin.org/fta/pub/services/btn/0708.html>



The Shift Towards a “Service Economy”

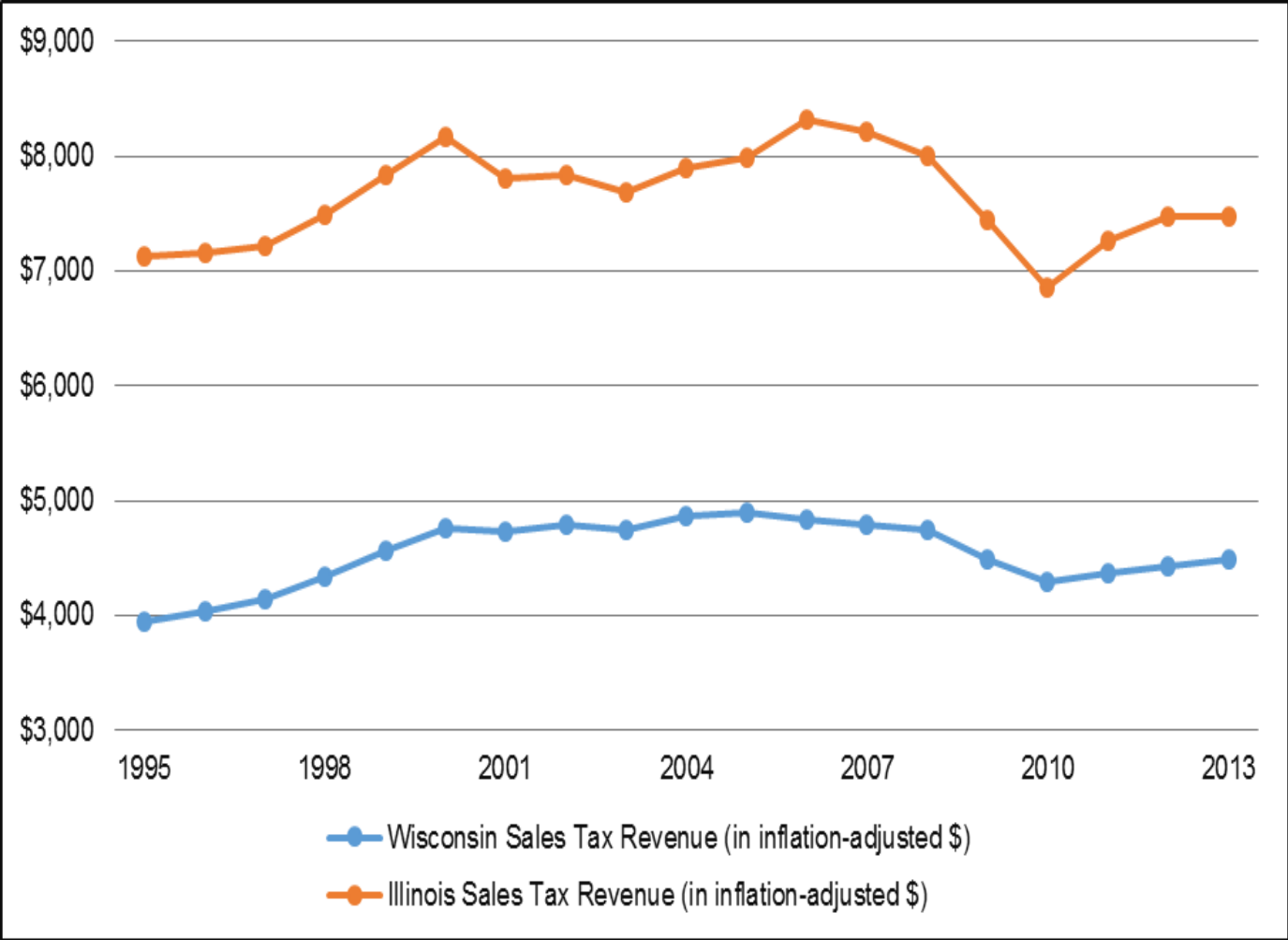
National Household Consumption: Goods versus Services



Source: Michael Mazerov, *Expanding the Sales Taxation of Services: Options and Issues* (Washington, DC: Center for Budget and Policy Priorities, July 2009), v.



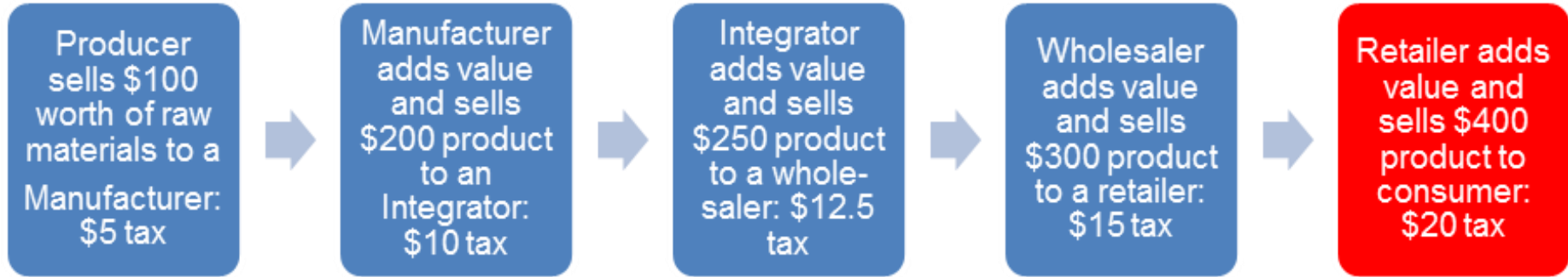
Comparison of Illinois and Wisconsin State Level Sales Tax Revenue, adjusted for inflation



Sources: COGFA, *Illinois Revenue Volatility Study: Public Act 98 – 0682*, (Springfield, IL: December 31, 2014), 13; Wisconsin data from the U. S. Census State Government Tax Collections, <https://www.census.gov/govs/statetax/index.html>



Tax Pyramiding



Hypothetical courtesy of Center for Tax and Budget Accountability

- Tax should apply only once, at the final step: \$20 in tax
- Without B-to-B exemption, total tax : \$62.50
- Tax burden is buried—not visible to ultimate payor (consumer)
- Large firms advantaged over small ones



Taxing Services—Administrative Concerns

- A Business-to-Business exemption of some sort is mandatory, but how to execute?
- New “retailers” in the system—education, what is de minimis?
- Public perception: tax increase, even if rates drop
- Sourcing, sourcing, sourcing
- Exacerbates existing quirks: a “retailers’ occupation” tax, SOT and SUT, etc.



Income Tax Issues

- Rates :
 - individuals: 3.0% → 5.0% → 3.75%
 - corporations: 7.3% → 9.5% → 7.75%
- Local Government Share (LGDF)
 - In 2012, counties received \$131.4 million
 - Gov's proposed budget: 50% cut
- Retirement Income
- Personal Property Tax Replacement Income Tax ("PPRT")
- The ever-popular "Loopholes"



Retirement Income

- Illinois exempts all retirement income:
 - social security
 - public and private pensions
 - IRAs
 - 401(k)
- Federal government taxes them (except some social security)
- Annual cost: \$2.3 Billion in 2012
- 41.5% of seniors believe Illinois' state income tax on retirement income is "too high"



More retirement data

- From 2007 to 2012:
 - Illinois returns filed decreased 0.5%
 - AGI on those returns increased 7.5%
 - # with retirement subtraction increased 9.0%
 - Size of subtraction increased 36.0%
- In 2012:
 - More than half of retirement subtraction claimants were under 65
 - Returns with >\$100,000 AGI made up nearly half of total retirement subtractions



Personal Property Tax Replacement Income Tax

The 1970 Illinois Constitution:

- Abolished the property tax on personal property
- Required it to be replaced with another revenue source by 1979.

The “Replacement Tax”:

- 2.5% income tax on corporations
 - 1.5% income tax on partnerships, trusts, and subchapter S corporations
 - Various utility taxes
-
- Allocated to local governments based on their share of personal property tax collections in 1976 or 1977.
 - Counties received \$107.4 million in FY 2012 (8.69% of statewide collections).



Corporate tax changes

Tax expenditures = revenue foregone

- Most benefit individuals and are for social policy reasons (exempting retirement income, food, charities)
- Some are for tax policy reasons (minimizing pyramiding)
- A few are economic development incentives, like the EDGE credit (occasionally labeled “loopholes”)



But—Isn't it True that Two-Thirds of Corporations Don't Pay Income Tax?

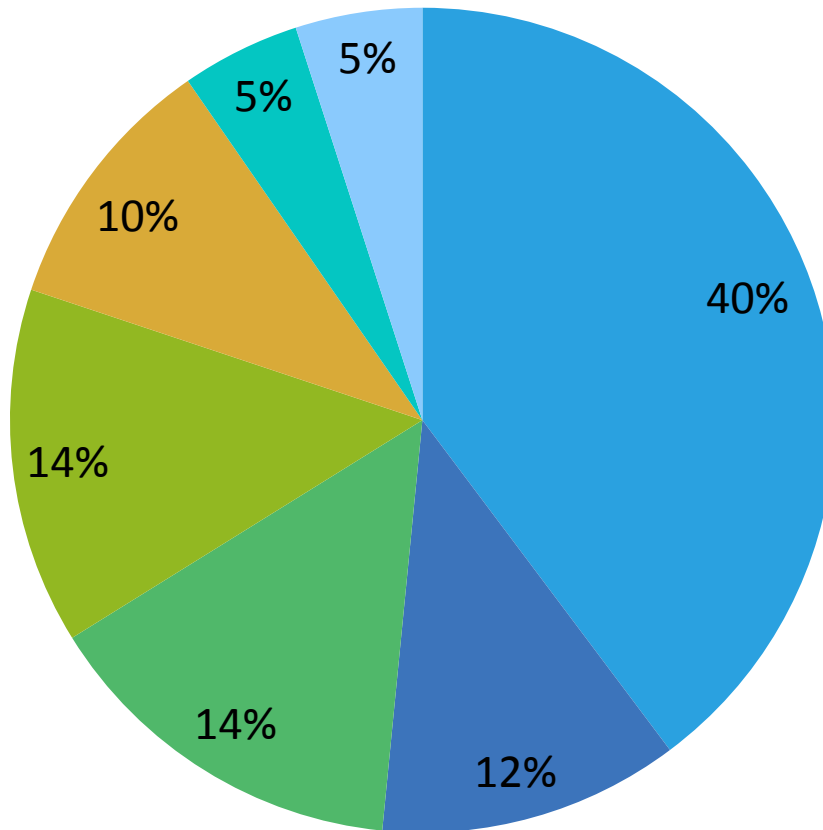
- Yes, but an incomplete picture
- Of those non-payors:
 - 95% had no federal taxable income
 - 78% were Illinois-only businesses
 - 0.2% claimed credits

Source: Probing Beneath the Surface: Understanding Why So Many Corporations Do Not Pay Illinois Corporate Income Tax; JD Michael LLC (Dr. Natalie Davila) February, 2014



Total Taxes Paid by Business

Total State and Local Business Taxes FY 2013



In Billions

Property Tax	\$12.8
Sales Tax	\$3.8
Excise Tax	\$4.7
Corporate Income	\$4.5
Unemployment	\$3.3
Individual Income	\$1.5
License and other	\$1.6

Total = 45.4% of all
state and local taxes
paid in IL

Source: Ernst & Young LLP



What's In Store?

- Budget talks—will tax and labor issues become part of the debate?
- Pension reform: Illinois Supreme Court expected to weigh in soon on 2013 law
- Everyone has a “wish list” of tax law changes—will any of them see the light of day?



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