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TAXPAYERS'  
FEDERATION  
— OF ILLINOIS —

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# Budget and Taxes: The Good, the Bad, and Illinois

Blackhawk Hills Regional  
Council  
October 19, 2018

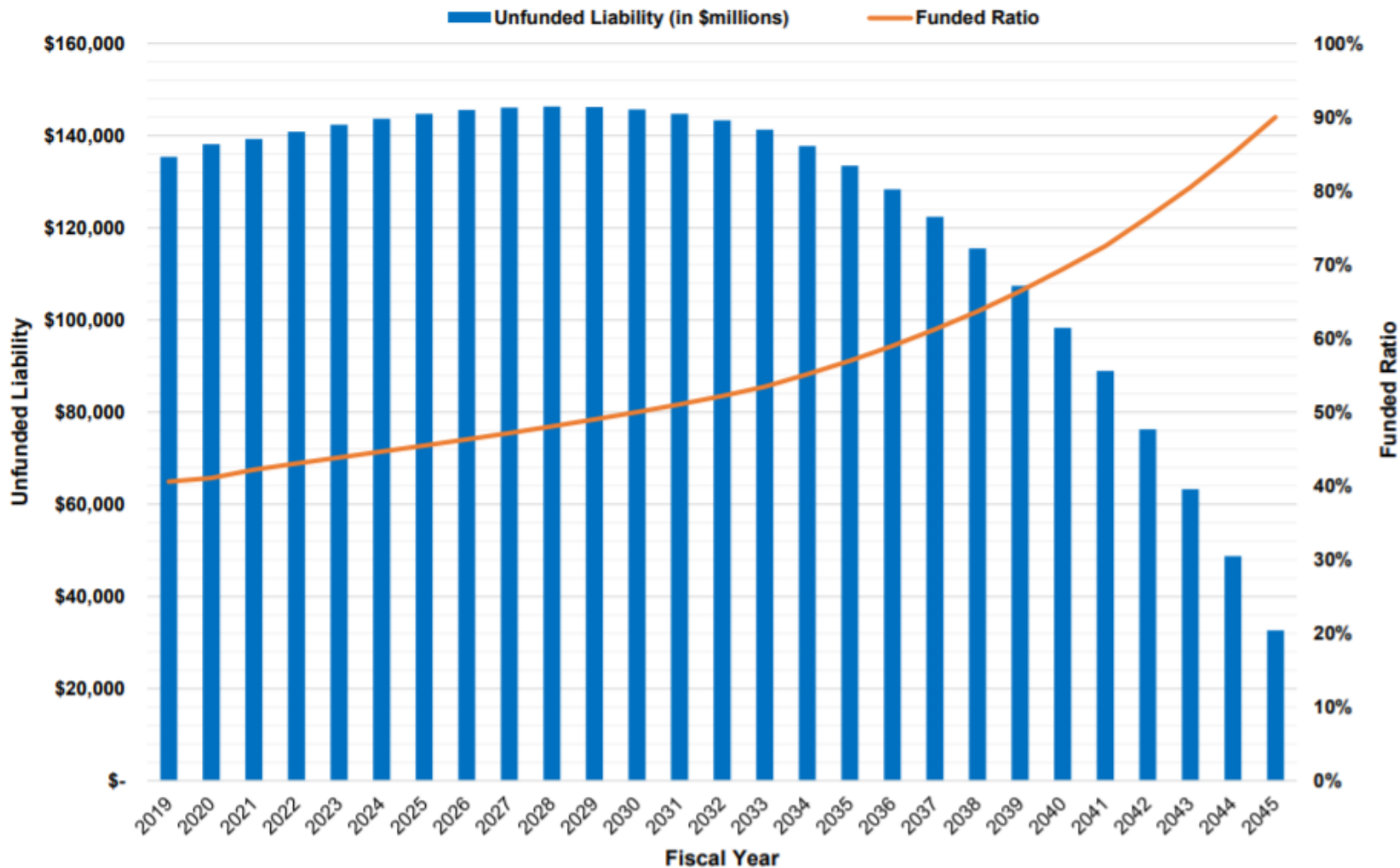
# The State of Our State

- **Backlog of Unpaid Bills:** **\$7.4 Billion**  
As of 10/9/2018 (down from \$16.3 Billion in mid-2017)
- **Bond Rating:** **Baa3/BBB-/BBB**  
Moody's, S&P, and Fitch, respectively.
- **Schools in Deficit Spending:** **48%**  
2017 Projection from ISBE
- **Unemployment:** **4.1%**  
August 2018. US: 3.9%



# Depressing Chart of the Day, Part I

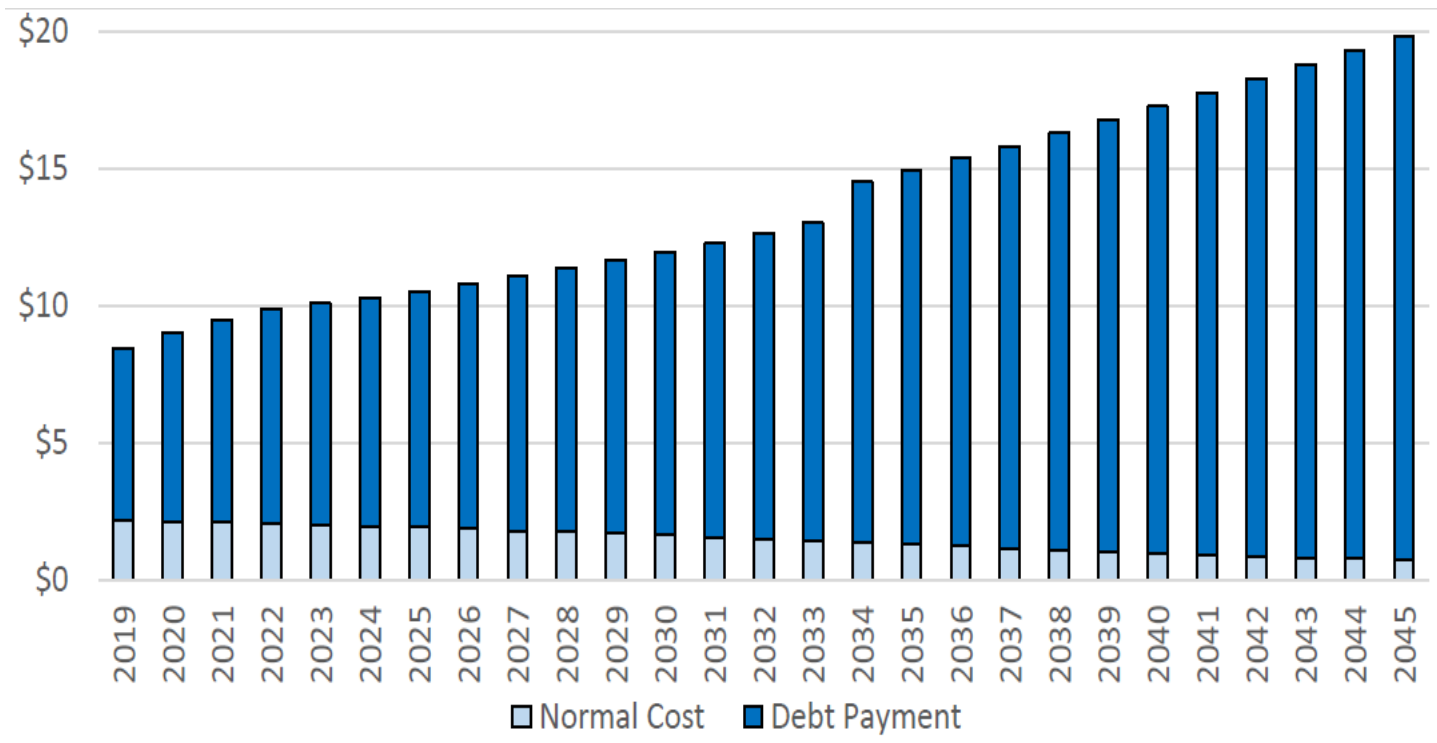
State of Illinois Retirement Systems Projected Financial Condition:  
FY2019 to FY2045



Source: Institute for Illinois' Fiscal Stability at the Civic Federation, FY19  
Recommended Budgets Analysis and Recommendations, 5/9/18, p. 37

# Depressing Chart of the Day, Part II

## Projected State Pension Contributions (in \$billions)



Source: Center for Tax and Budget Accountability, *Addressing Illinois' Pension Debt Crisis*, 5/21/18



# FY 2019 Budget – P.A. 100-0586/0587

- Passed 56-2-0 & 97-18-0
- Appropriates \$38.5 billion in GRF – increase of \$600 million from FY 2018
- \$350 million increase to k-12 for new funding formula
- Reduces LGDF to municipalities by 5% (was 10%) and sales tax fee reduced from 2% to 1.5% - increase of \$120 million to local governments
- Pension buyout option
- \$800 million in interfund borrowing



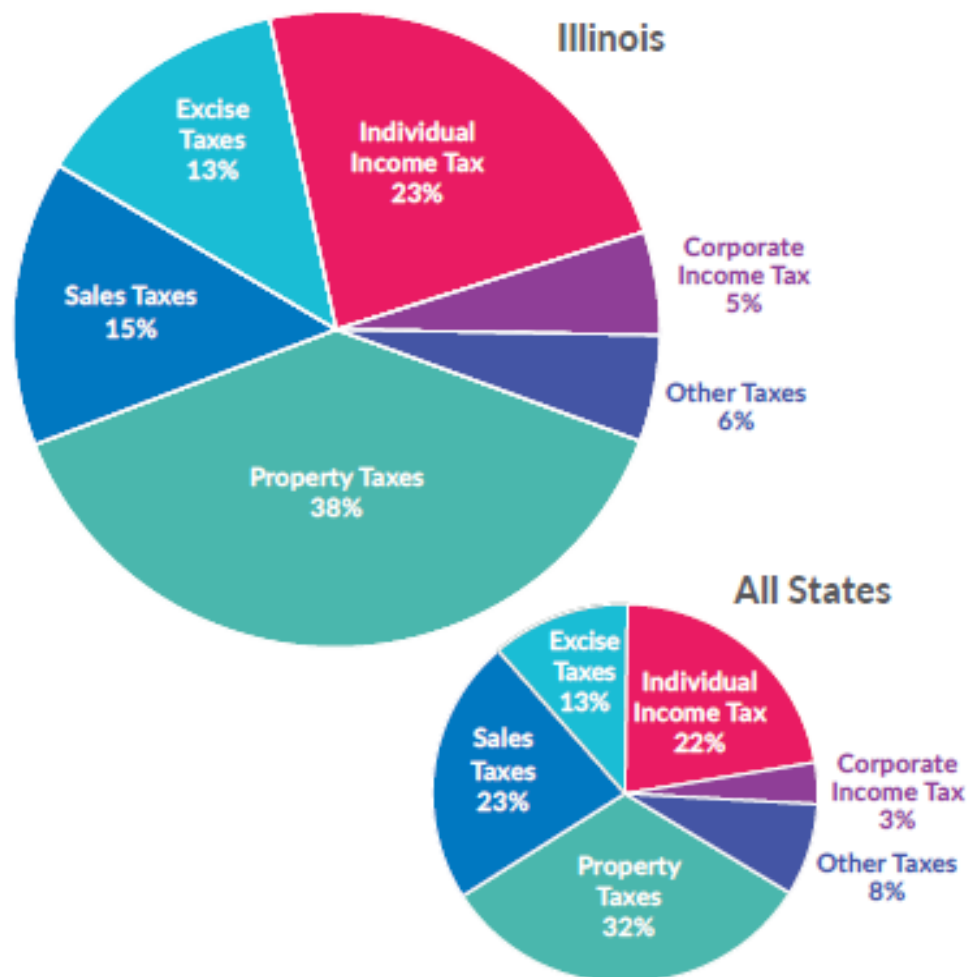
# Illinois consequences of federal reform

- Predicted Fiscal Impact:
  - \$503 - \$668 million in FY18; \$(137) - \$34 million in FY19
- Most individual changes won't matter in Illinois:
  - Rates and bracket changes
  - Increased standardized deduction, Reduced itemized deductions
  - Personal exemption is NOT a problem. \$0 but still in IRC, so Illinois' cross-reference is still effective
- Many corporate changes are also irrelevant:
  - Rates, AMT repeal, new excise tax, NOLs
  - Other changes will be followed automatically by Illinois— interest deduction deferral, most international changes
- A few open questions and odd glitches to fix (e.g., bonus depreciation, mis-matched interest disallowances)



## Compared to the Entire U.S., Illinois Relies More on Property Taxes, Less on Sales Taxes

Percent of Total Combined State and Local Tax Collections by Tax Type, Illinois and U.S. (2012)

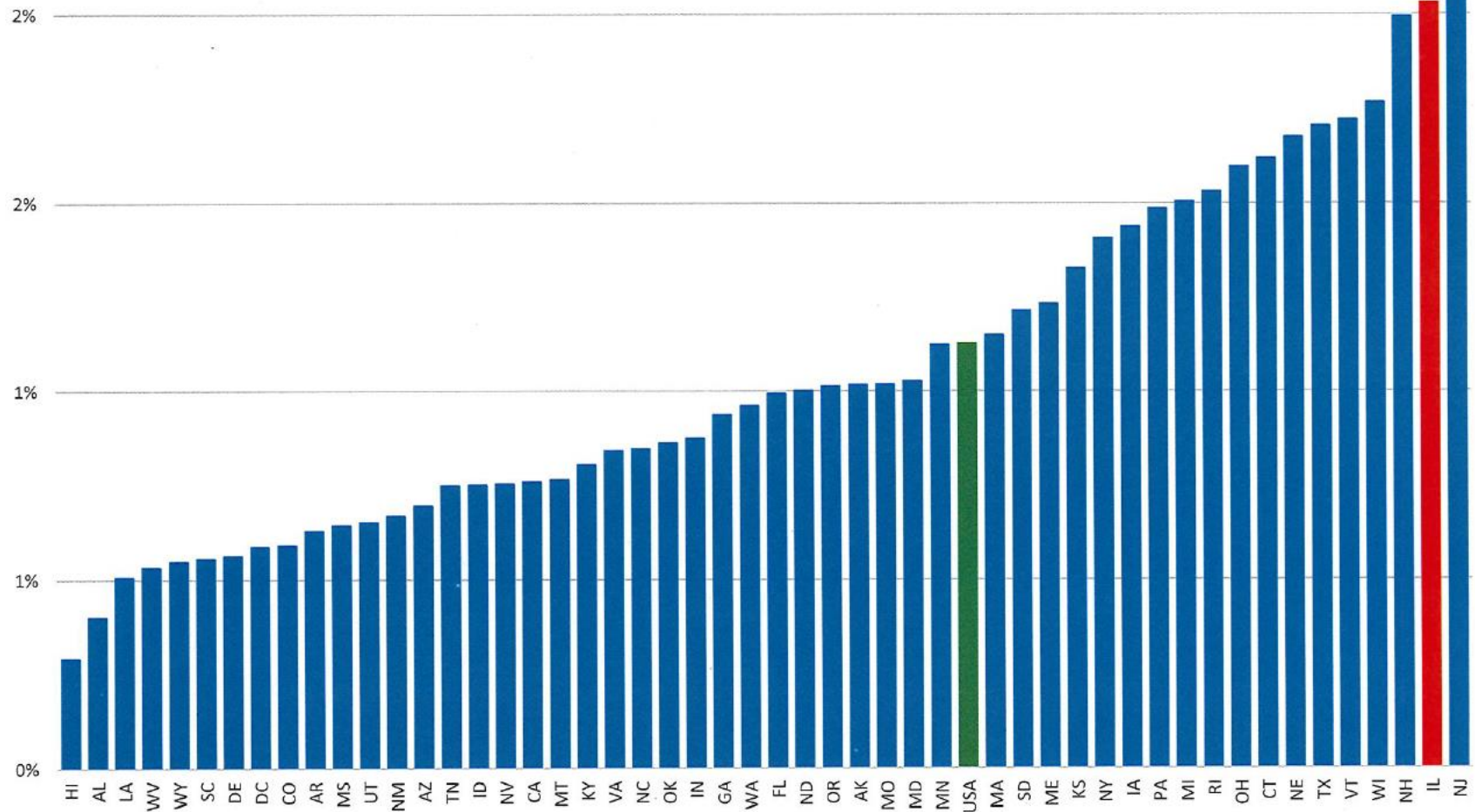


Illinois obtained the largest share of state and local combined collections in 2012 from property taxes (38 percent of total), followed by individual income taxes (23 percent) and general sales taxes (15 percent). The Illinois property tax share is higher than the U.S. average, and the sales tax share is lower. Corporate income taxes make up the smallest share of collections in both Illinois and the U.S. as a whole, although Illinois relies on them a slightly more than other states.

Note: Percentages may not add to 100 due to rounding.  
Source: Census Bureau, *State and Local Government Finances*.

# Illinois' Residential Effective Property Tax Rates Are High

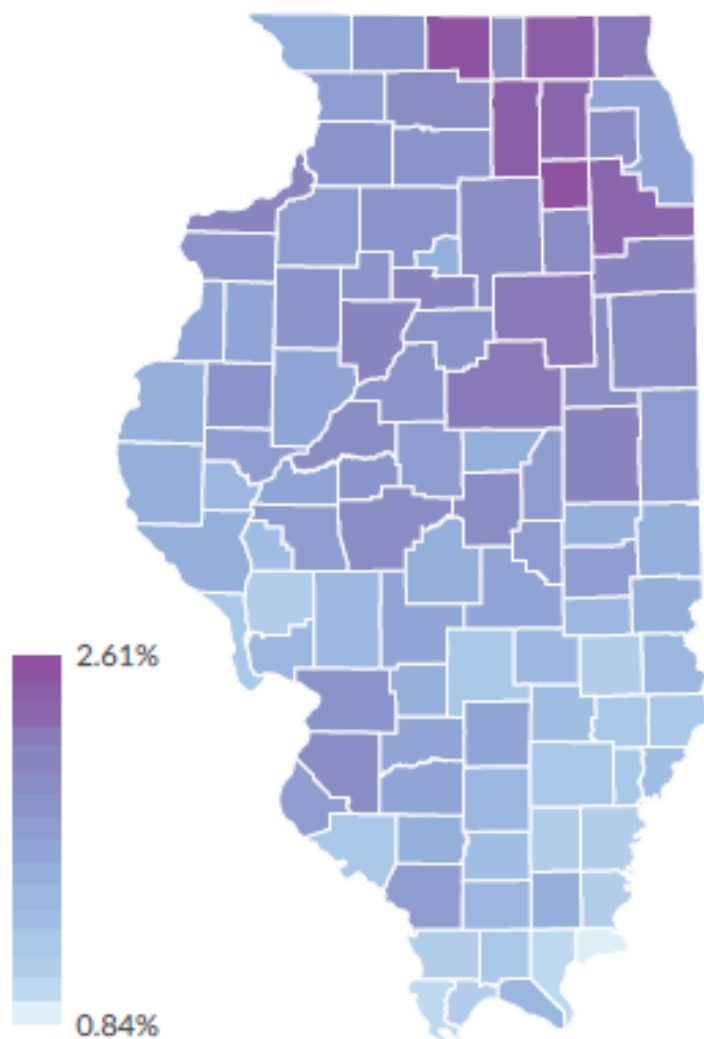
Real Estate Taxes Paid as a Percent of Housing Value of Owner-Occupied Housing Units  
(5-year Estimate, 2012 – 2016)





# Residential Effective Property Tax Rates Vary Widely among Counties

**Aggregate Real Estate Taxes Paid as a Percent of Aggregate Housing Value of Owner-Occupied Housing Units (5-Year Estimate, 2009-2013)**



On average, the residential effective property tax rate in Illinois (using a five year average from 2009 to 2013) was 1.92 percent, though county-specific values vary around this mean. The highest residential effective rate occurred in Kendall County at 2.61 percent, while the lowest was in Hardin County at 0.84 percent. Cook County, the home of metropolitan Chicago, had an effective property tax rate of 1.68 percent.

Within a county, individual homeowners' effective rates may differ from these county averages. For example, a home in Cook County could have drastically different effective property tax rates depending on where it sits—a recent study found that a \$250,000 home in Chicago in 2010 had an effective property tax rate of 1.28 percent, while a home with the same market value in Park Forest (also in Cook County) had an effective rate of 5.68 percent.

It's important to note that an effective property tax rate is not the same as the millage rate (that is, the statutory property tax rate levied by a local government).

Note: "Residential Effective Property Tax Rate" is calculated by dividing the total real estate (property) taxes paid in a county by the county's total housing value (owner-occupied units only). The American Community Survey data used here is based on 5-year estimates (2009 to 2013). This data does not include commercial property.

Source: Census Bureau, American Community Survey; Taxpayers' Federation of Illinois, Tax Facts, Volume 66, No. 3 (Summer 2013).

# Property Tax “Freeze” Proposals

- The least popular tax—a freeze sounds great!
- What does it really mean?
  - *Not* an actual freeze of each land-owner’s tax bill
  - State-wide imposition of PTELL, set to 0%
- It can get complicated:
  - Temporary or permanent?
  - What about new property (new subdivision = more roads, more students, etc.), intersection with TIF rules, etc.
  - What if citizens are OK with more taxes—referendum to opt out



# Another Popular Bad Idea: Exemptions

- Homeowner exemptions lower the tax base of a qualifying home, but merely shift the total tax burden onto other properties
- For example, HB 156 in 2016 would have:
  - Increased general homestead exemption to \$8,000 (was \$7K in Cook; \$6K elsewhere)
  - Increased senior homestead to \$6,000 (was \$5,000)
  - Created state-wide long-term-owner homestead exemption—8 years; income \$100K or less
  - Assessment freeze for SSI recipients
  - New \$2500 exemption for veterans over 75
  - Disabled veteran disability rating lowered to 20%
- TFI examined the consequences of the bill (which did not become law, although many of its provisions were enacted)



# HB 156--Impact of New Exemptions

Exemption	Estimated EAV Reduction
Increase in General Homestead	\$5,170,356,000
Increase in Senior Exemption	\$806,381,000
Long-time Homeowner Exemption	\$2,569,517,600
75 Year Old Veteran Exemption	\$302,387,500
Lowering Disability Threshold	\$2,904,062
<b>Total</b>	<b>\$8,851,546,162</b>

Source: Illinois Department of Revenue Statistics for 2015 tax year, US Census Bureau data, TFI calculations



# Impact of Exemptions on Total EAV and Rates

Region	EAV Before Exemptions	EAV After Current Exemptions	Estimated Value of Exemptions in HB 156	Tax Extensions
Statewide	\$341,582,737,847	\$314,453,836,484	\$8,851,546,162	\$28,745,388,566
Cook County	\$151,672,060,244	\$141,430,912,748	\$2,256,313,311	\$13,066,967,977
Collar Counties	\$102,493,052,545	\$95,874,231,703	\$2,680,817,015	\$8,878,610,719
Rest of State	\$87,417,625,058	\$77,148,692,033	\$3,914,415,836	\$6,799,809,869

Region	Tax Rate Without Exemptions	Tax Rate With Current Exemptions	Tax Rate With Exemptions in HB 156	Percentage Increase
Statewide	8.42%	9.14%	9.41%	2.90%
Cook County	8.62%	9.24%	9.39%	1.62%
Collar Counties	8.66%	9.26%	9.53%	2.88%
Rest of State	7.78%	8.81%	9.29%	5.35%



# Impact on a Sample Collar County Home

- Tax savings from an increased exemption are NOT merely the rate times the increased exemption:  $\$2,000 \times 9.26\%$ , or \$185.20
- Instead, the higher rate must be part of the calculation:

Scenario	Current Law	HB 156
Market Value	\$200,000	\$200,000
Equalized Assessed Value	\$66,667	\$66,667
Homestead Exemption	\$6,000	\$8,000
Taxable EAV	\$60,667	\$58,667
Rate	9.26%	9.53%
Tax Bill	\$5,618.15	\$5,589.22
Savings	\$28.93	



# Impact by Classification

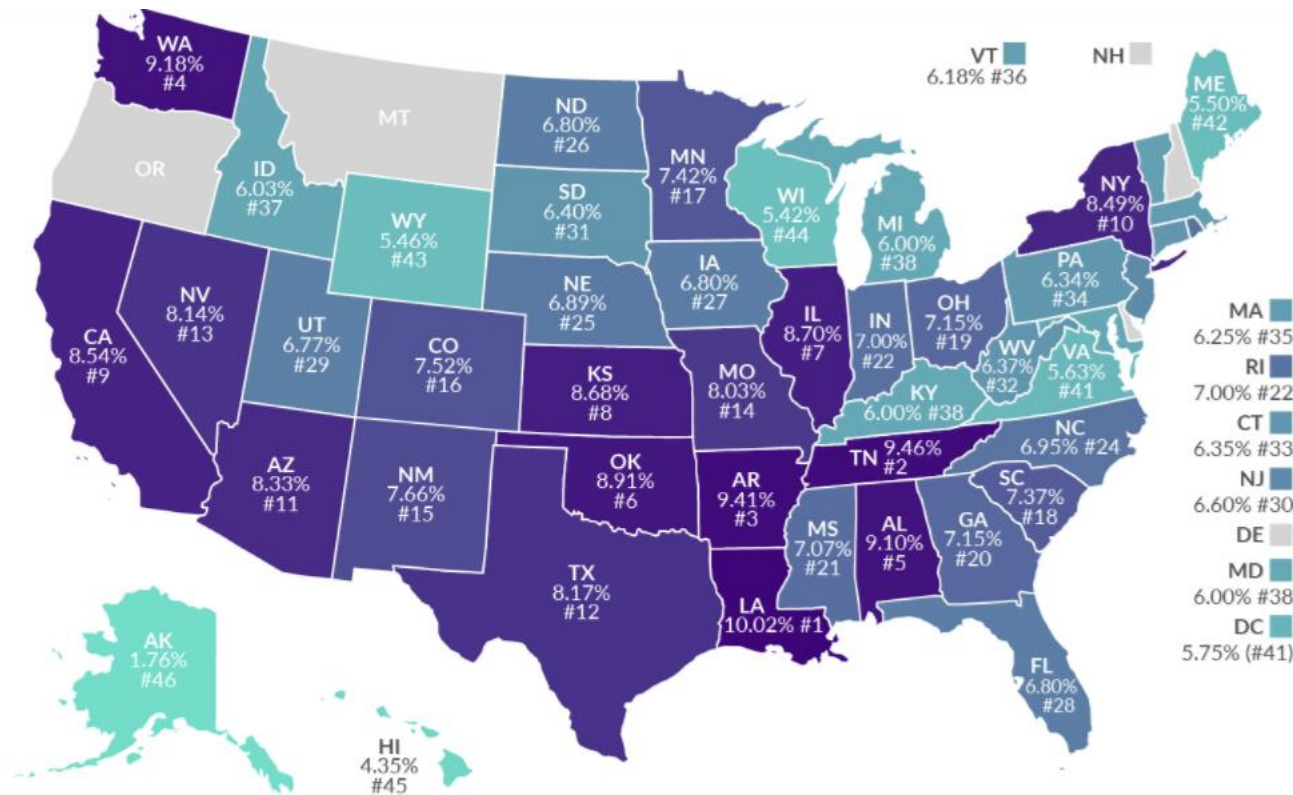
Unless taxing jurisdictions lower their levies, the savings from HB 156 to owner-occupied residential properties will be exactly equal to the total increased taxes paid by the other property types:

Class	Property Taxes Paid Without Exemptions	Property Taxes Paid With Current Exemptions	Property Taxes Paid Under HB 156	Difference Between Current Law and HB 156
Farm Non-Residential	\$695,769,532	\$755,579,455	\$777,457,816	\$21,878,361
Residential Rental	\$7,032,800,539	\$7,637,355,983	\$7,858,501,268	\$221,145,285
Commercial	\$6,020,385,632	\$6,537,911,600	\$6,727,221,661	\$189,310,061
Industrial	\$2,493,676,348	\$2,708,038,408	\$2,786,451,661	\$78,413,253
Residential Owner Occupied	\$12,502,756,514	\$11,106,503,120	\$10,595,756,159	-\$510,746,960





# Illinois' State + Average Local Sales Tax Rate is Relatively High



Note: City, county, and municipal rates vary. These rates are weighted by population to compute an average local tax rate. Three states levy mandatory, statewide, local add-on sales taxes at the state level: California (1.25%), Utah (1.25%), and Virginia (1%); we include these in their state sales tax. The sales taxes in Hawaii, New Mexico, North Dakota, and South Dakota have broad bases that include many services. This map does not include sales taxes in local resort areas in Montana. Salem County is not subject to the statewide sales tax rate and collects a local rate of 3.3125%. New Jersey's average local score is represented as a negative.

Source: Sales Tax Clearinghouse, Tax Foundation calculations, State Revenue Department websites

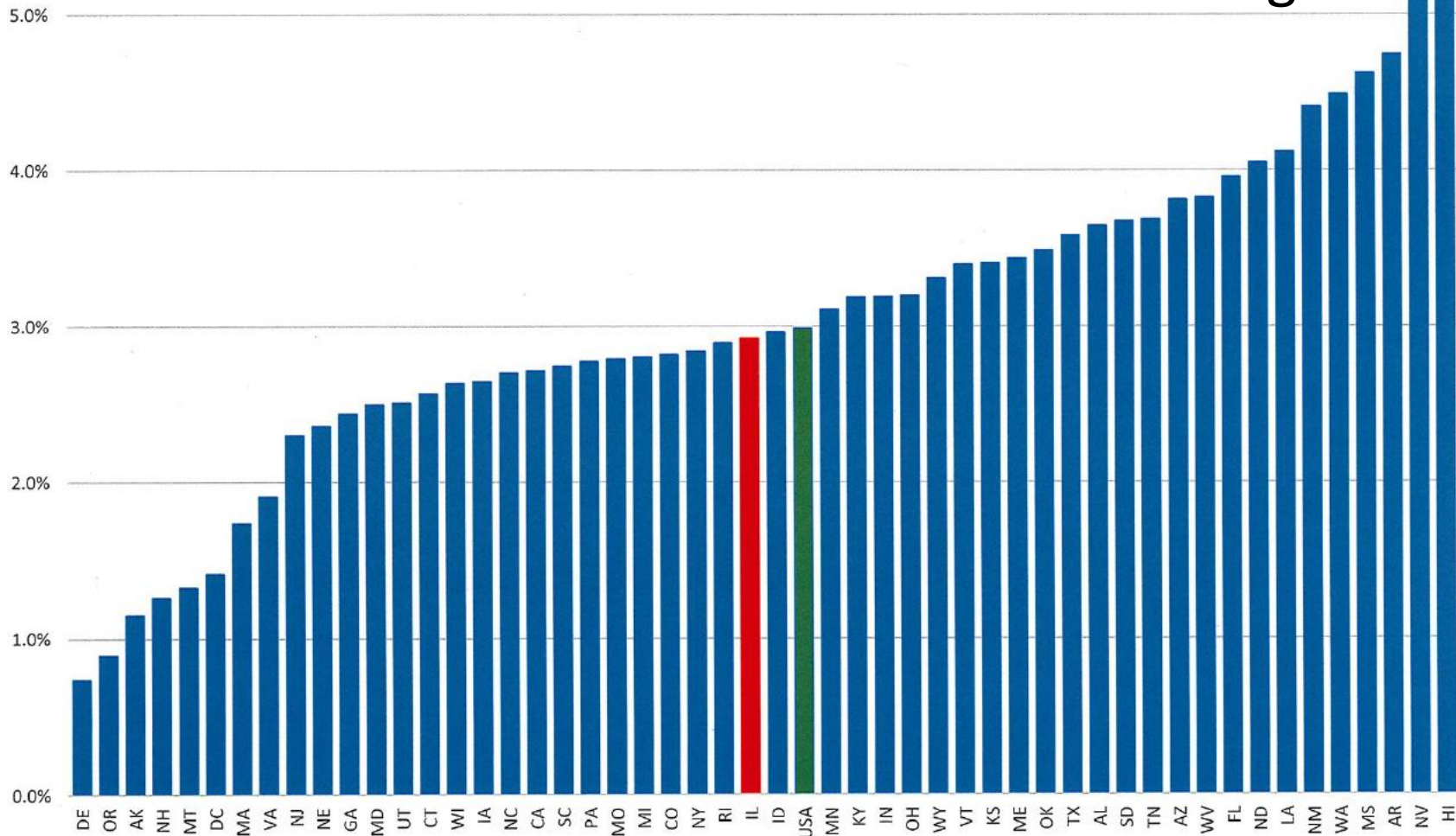


Source: Tax Foundation, 1/1/2018





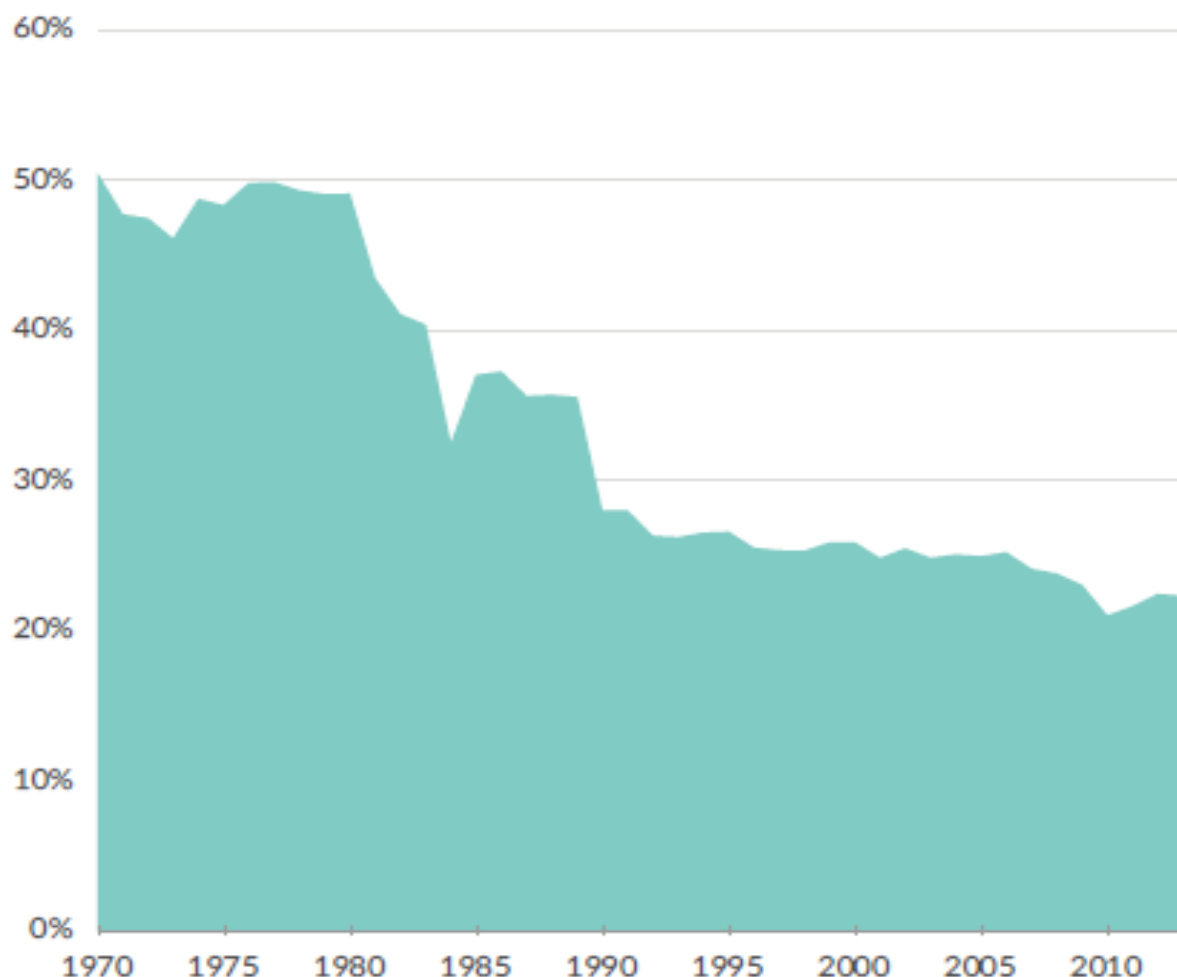
## But—Illinois' Total Sales and Excise Tax Collections Are Close to the National Average



State and Local Sales and Excise Tax Revenue as a Percentage of Gross State Product, Fiscal Year 2015

# Illinois' Sales Tax Applies to Less and Less of the Economy

## Illinois' Sales Tax Breadth (1970-2013)



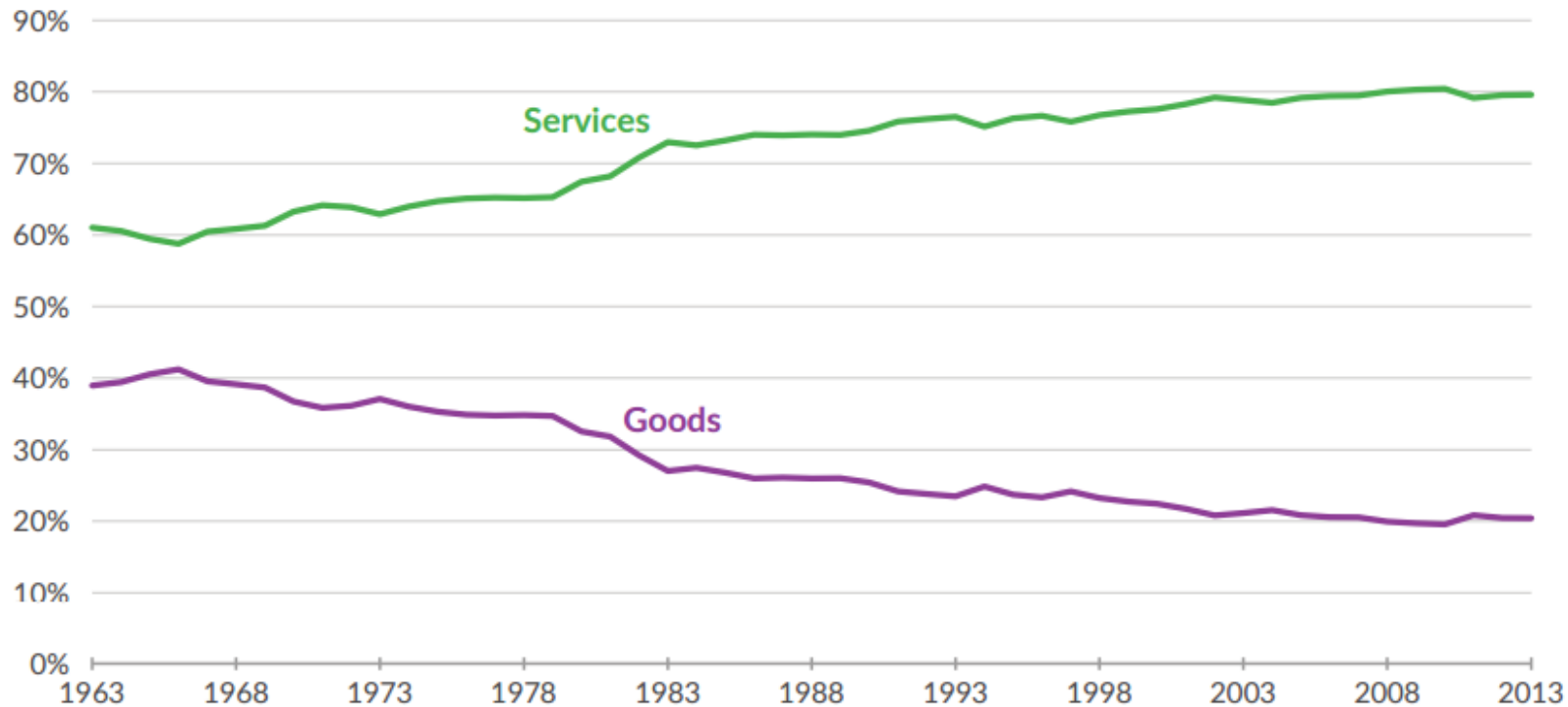
An ideal sales tax is one that is levied on all final consumer purchases. By taxing a large number of transactions, the rate can be kept low and still raise sufficient revenue.

When sales taxes were created in the 1930s, they were levied on tangible goods, which at the time were a large part of the overall economy. However, the economy has become more service based since then. As a result, the sales tax is not nearly as productive. Further, by failing to tax consumer services, the sales tax inherently favors the services sector of the economy over the goods sector.

Note: Sales tax breadth is defined as the ratio of the implicit sales tax base to state personal income.  
Source: Professor John Mikesell (Indiana University).

# Illinois' Economy Is Moving away from Goods and toward Services

Services and Goods as a Percent of Total Private State GDP, Illinois Statewide (1963-2013)



Five decades ago, economic sectors involving the production of tangible goods—agriculture, manufacturing, construction, and mining—made up approximately 40 percent of the Illinois economy (based on the share of state GDP). Today, those sectors only comprise 20 percent of the state's economy, while service-providing industries make up the remaining 80 percent.

Source: Bureau of Economic Analysis, Regional Economic Accounts, Gross Domestic Product (GDP) by State, "GDP in current dollars."



# “Service” Tax

- Not necessarily a completely new tax regime; could expand 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



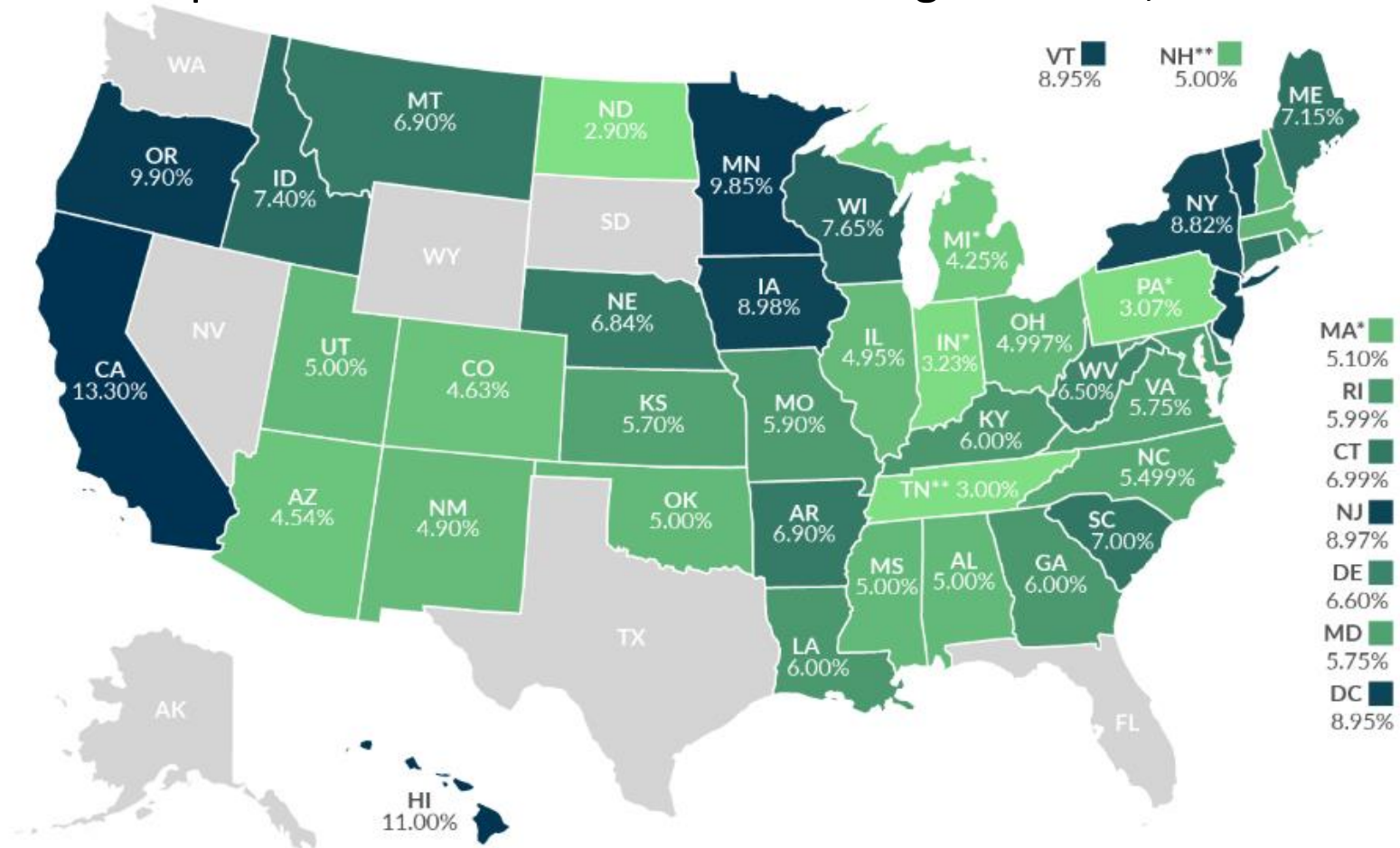
# *Wayfair v. South Dakota*

- States can now make a retailer collect tax on remote sales, even if the retailer has no physical presence in the state
- Illinois copied South Dakota law, effective 10/1/18 (small sellers still exempt)
- \$150 million new state revenue in FY 19
- **Not** a new tax, just a level playing field
- Other implications:
  - \$ for local governments, too
  - Illinois sellers may have to collect other states' tax



# Our Income Tax Rates Are Below Average

Top State Individual Income Tax Marginal Rates, 2018



Note: (\*) State has a flat income tax. (\*\*) State only taxes interest and dividends income. Map shows top marginal rates: the maximum statutory rate in each state. This map does not show effective marginal tax rates, which would include the effects of phase-outs of various tax preferences. Local income taxes are not included.

Source: Tax Foundation; state tax statutes, forms, and instructions; Bloomberg BNA.

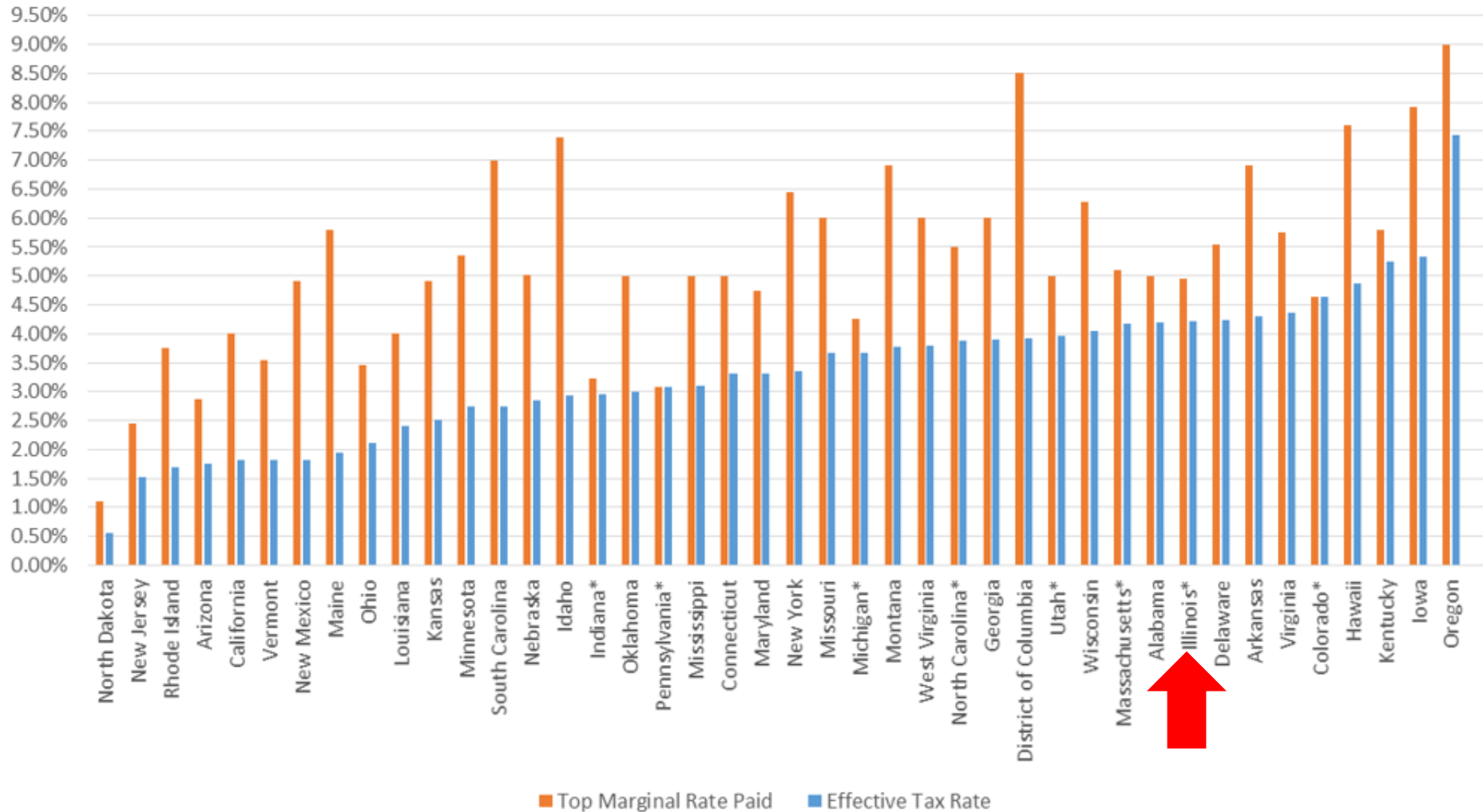


Source: Tax Foundation



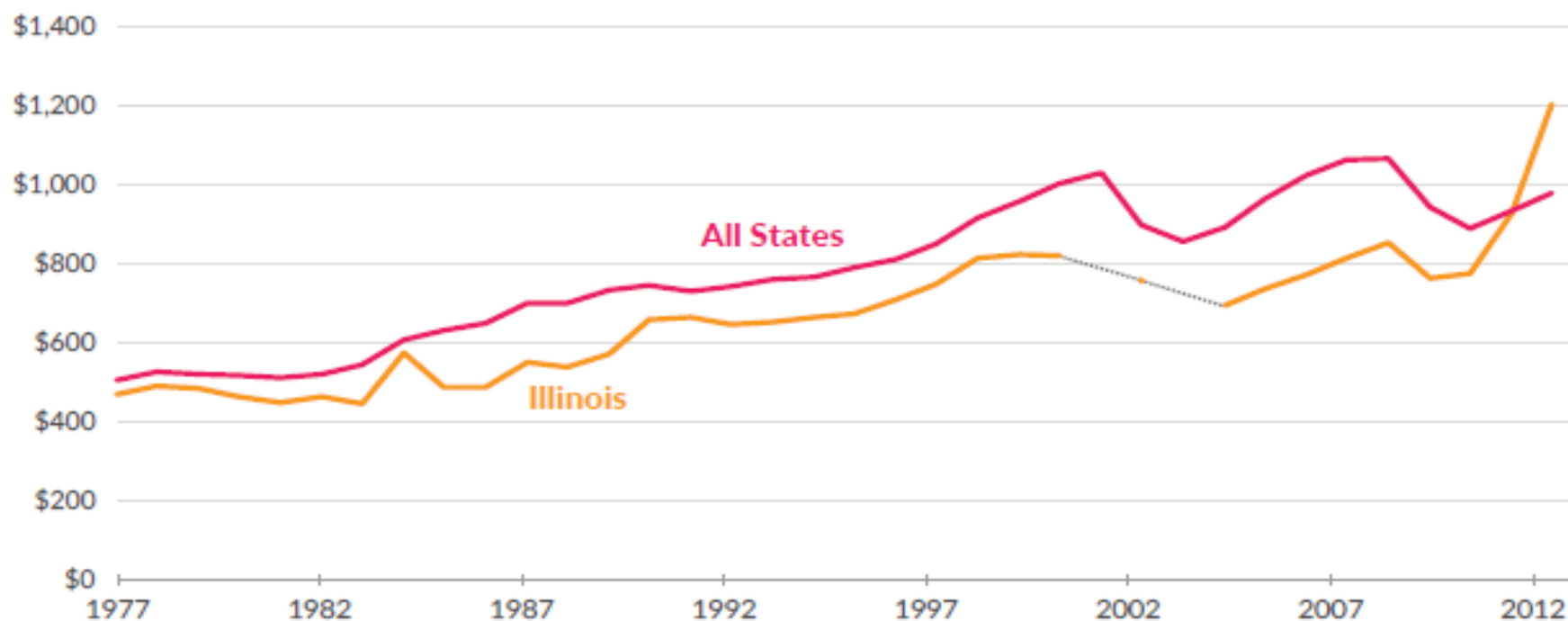
# But—top Marginal Rate Doesn't Necessarily = Effective Rate

A median income Illinois family (\$59,196) in other states with a broad-based income tax



## Illinois' Individual Income Tax Collections per Person over Time

**Total State and Local Individual Income Tax Collections per Capita, Illinois and U.S.  
(1977-2012, in 2012 Dollars)**



Prior to 2012, inflation-adjusted individual income tax collections per person in Illinois were lower than state and local collections in the country on average. In 2012, however, this trend flipped due to a substantial increase in Illinois' individual income tax rate.

Note: Dollar amounts are inflation-adjusted based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2012 base year. Because local data is unavailable for 2001 and 2003, those points were excluded here, and points surrounding these years are connected with dotted lines.

Source: Census Bureau, *State and Local Government Finances*; Census Bureau, *American Community Survey*; Bureau of Labor Statistics, *Consumer Price Indexes*.

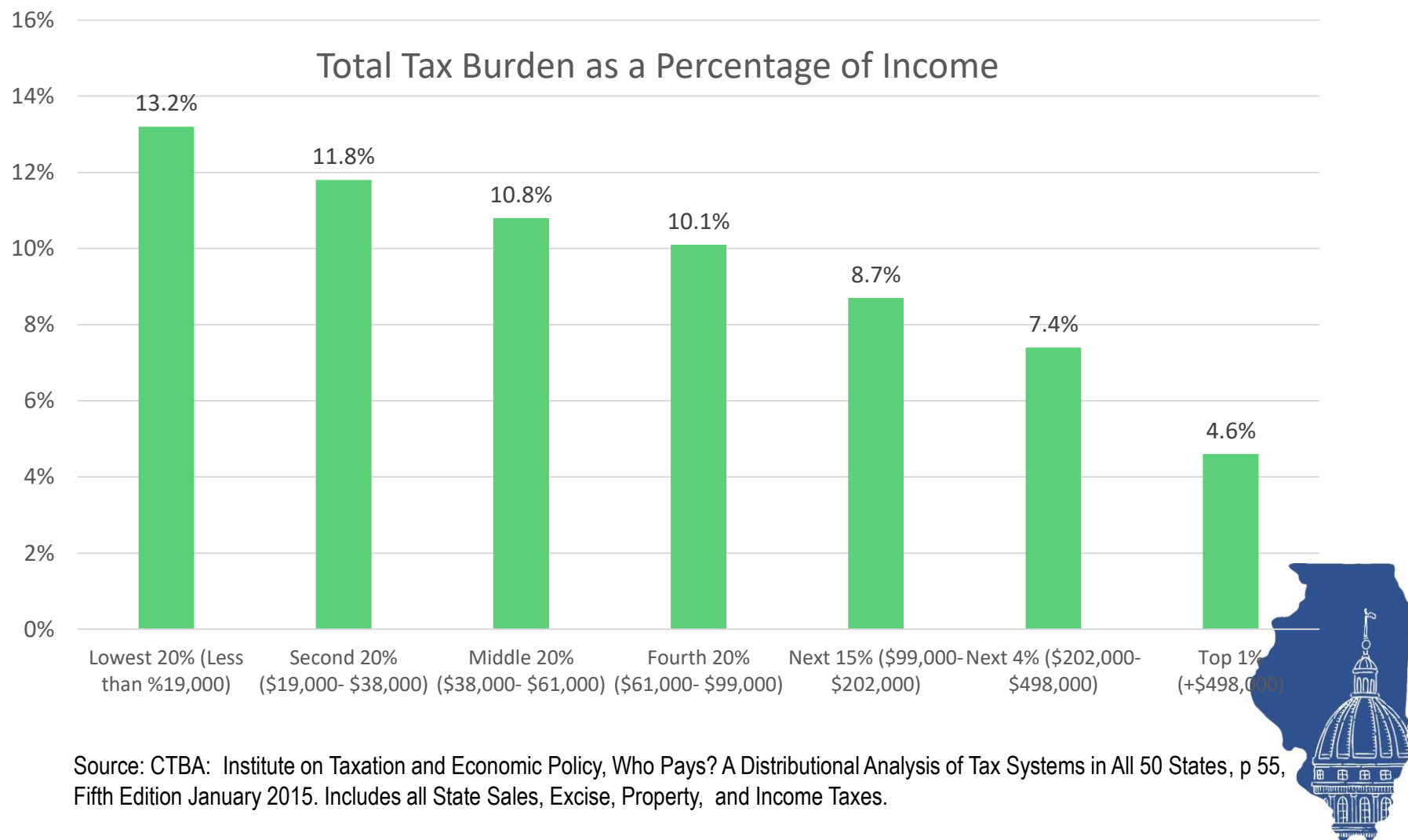


# Arguments for a Progressive Tax

- It's Fair
  - Vertical v. Horizontal Equity
  - The eye of the beholder
- It'll bring in more \$
  - And that \$ will come from the 1%
- More flexibility



# Illinois State & Local Taxes Paid as a Share of Family Income for Non-Elderly Taxpayers



# How Much More \$? It Depends

Comparison of Personal Income Tax Rate and Bracket Structures				
Illinois Tax Year 2015 Base				
Proposal	Brackets	Tax Rates	Estimated Net Revenue (billions)	Estimated Breakeven Income Level*
<b>Illinois Baseline</b>	All income	4.95%	<b>\$0</b>	n/a
<b>Iowa 2018 Brackets</b>	\$0 - \$1,598	0.36%	<b>\$7.3</b>	<b>\$33,000</b>
	\$1,598 - \$3,196	0.72%		
	\$3,196 - \$6,392	2.43%		
	\$6,392 - \$14,382	4.50%		
	\$14,382 - \$23,970	6.12%		
	\$23,970 - \$31,960	6.48%		
	\$31,960 - \$47,940	6.80%		
	\$47,940 - \$71,910	7.92%		
	\$71,910 and up	8.98%		
<b>Wisconsin 2018 Married Joint Filer Brackets</b>	\$0 - \$15,270	4.00%	<b>\$3.7</b>	<b>\$31,000</b>
	\$15,270 - \$30,540	5.84%		
	\$30,540 - \$336,200	6.27%		
	\$336,200 and up	7.65%		
<b>Sample 3 Percentage Point Spread</b>	\$0 - \$10,000	3.75%	<b>\$1.0</b>	<b>\$75,000</b>
	\$10,000 - \$28,000	4.75%		
	\$28,000 - \$59,000	5.75%		
	\$59,000 and up	6.75%		

Source: Illinois Department of Revenue, Detailed Income Stratification Report, Tax Year 2015; Civic Federation Calculations.

\*Level of taxable income above which taxpayers will likely pay more than they currently do.



# Arguments Against a Progressive Tax

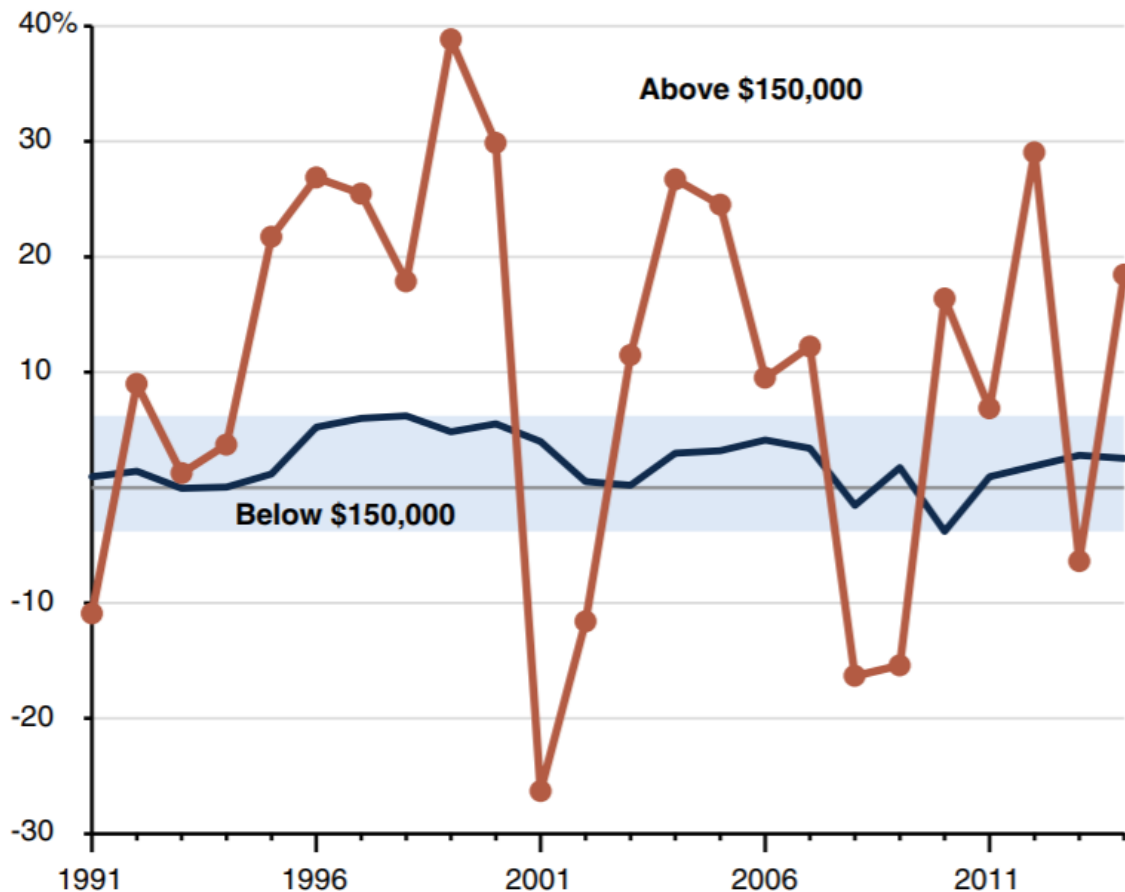
- A flat tax IS a fair tax
- Complicated
- Volatility
- Fear of “bracket creep”
- Out-migration risks
- Encourages more aggressive tax planning



# Relying on High-Earners Increases Volatility in Tax Collections

## Higher-Income Filers Have Especially Volatile Incomes

*Annual Percent Change in Adjusted Gross Income*



Source: California  
Legislative  
Analyst's Office,  
Volatility of  
California's  
Personal Income  
Tax Structure,  
9/28/17



# Backdoor Progressivity

- Earned Income Tax Credit—only available to the working poor
- New in 2017: Means-testing certain deductions (personal exemption) and credits (property tax and education expense)
- Another option: Means-testing Retirement Income Exemption



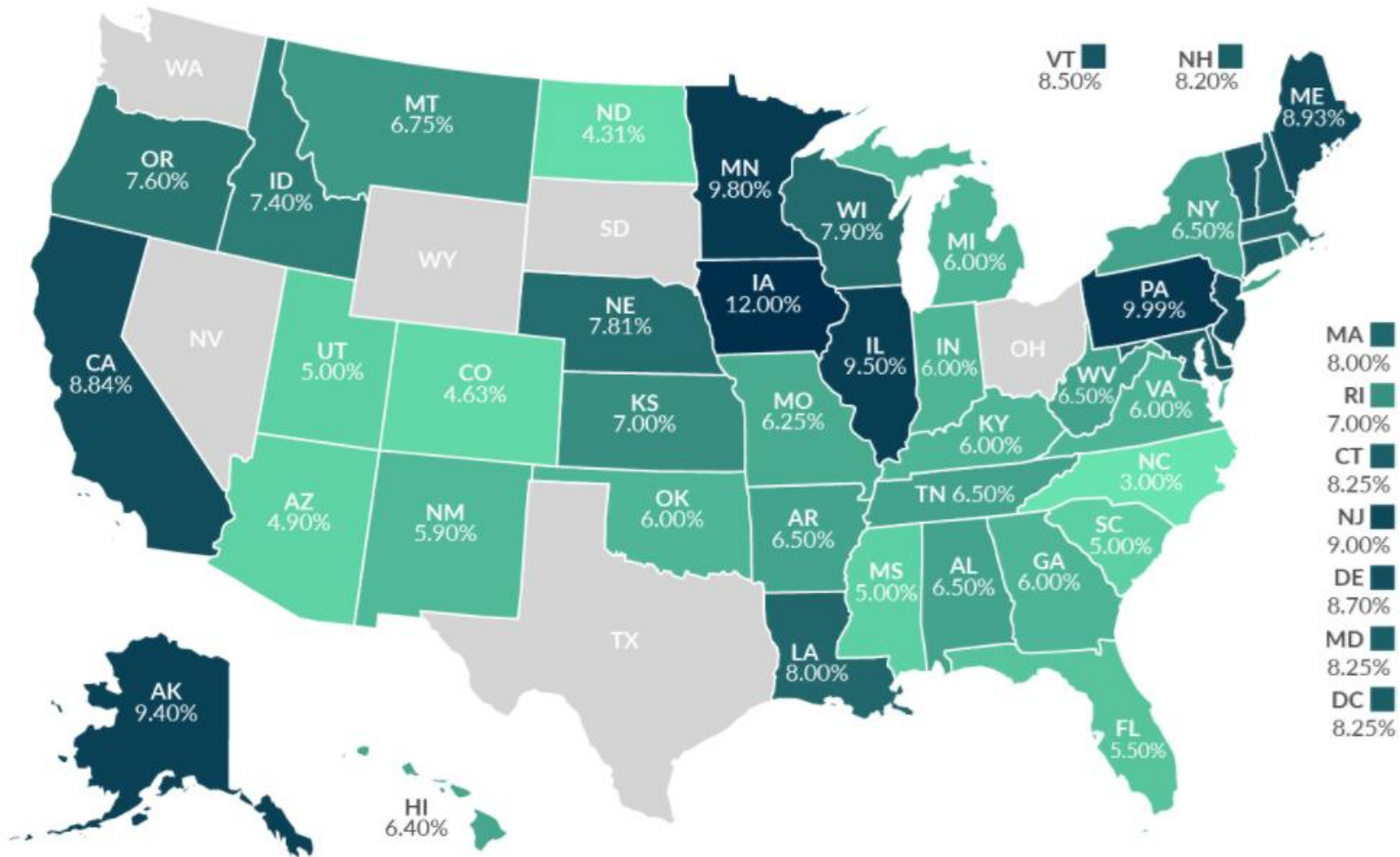
# Retirement Income

- Illinois exempts all retirement income:
  - social security
  - IRAs
  - public and private pensions
  - 401(k)
- Federal government taxes them (except some social security)
- Annual cost: \$2.3 Billion in 2015
- Age and income level are irrelevant.
  - More than half of retirement subtraction claimants were under 65
  - Returns with >\$100,000 AGI made up nearly half of total retirement subtractions
- Is there a better way?



# Our Corporate Income Tax Rate Is Relatively High

Top Marginal Rates in 2018, per the Tax Foundation



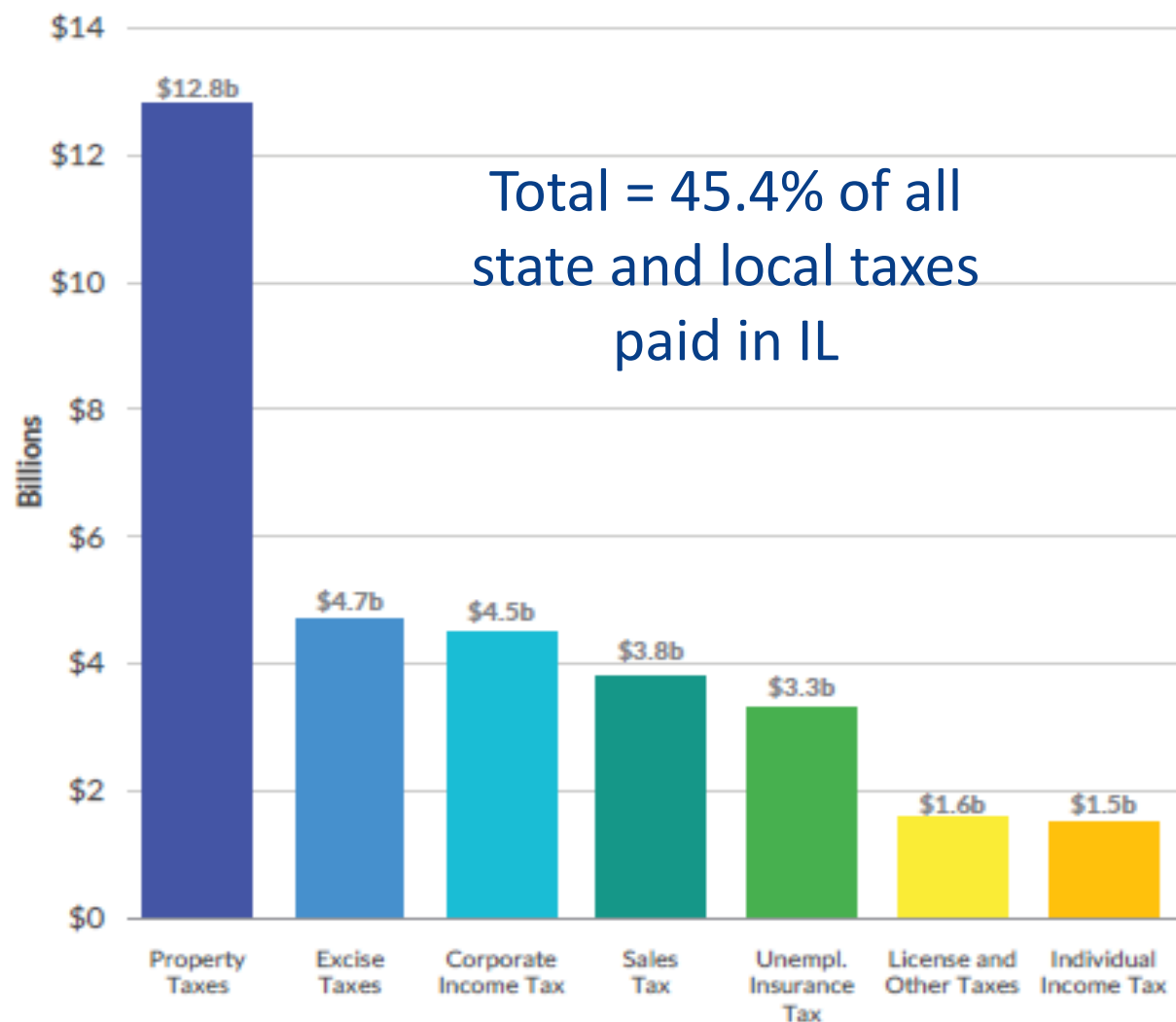
Note: (\*) Nevada, Ohio, Texas, and Washington do not have a corporate income tax but do have a gross receipts tax with rates not strictly comparable to corporate income tax rates. Arkansas has a "benefit recapture," by which corporations with more than \$100,000 of taxable income pay a flat tax of 6.5% on all income, not just on amounts above the benefit threshold. Connecticut's rate includes a 10% surtax, which effectively increases the rate from 7.5% to 8.25%. Surtax is required by businesses with at least \$100 million annual gross income. Illinois' rate includes two separate corporate income taxes, one at a 7.0% rate and one at a 2.5% rate.





# Businesses Don't Just Pay Corporate Income Taxes

## Illinois' Total State and Local Business Tax Liability by Tax Type (FY 2013)



A common misconception is that corporate income taxes are the only tax cost for businesses. However, businesses pay a number of other taxes, including property taxes on real estate, sales taxes on the goods they use, and individual income taxes on business income (if they're pass-through entities that file through the individual income tax code rather than the corporate income tax code).

Overall, Illinois businesses paid \$32.3 billion in taxes in 2013, with the largest portion going to property taxes.

Source: Council on State Taxation and Ernst & Young LLP, *Total state and local business taxes* (FY 2013).

# Predictions for 2019

- **Many** new legislators
- Rate-changes unlikely
- Further attempts to “close loopholes” and tax the guy behind the tree
- Always bet on nothing



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