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Illinois Revenue Initiatives & Enhancements

1. Increase the income tax: Enhancing the state's income tax has the most revenue generating potential of all available alternatives. It also is one of the most appropriate revenue sources to be used, for a number of reasons. Illinois' maximum combined state and local income tax rate is the lowest in the country and the state's overall tax burden ranks 48th when all state and local taxes, charges and user fees are considered. Moreover, state income taxes can be deducted from federal income tax obligations. Finally, because the tax is based on income, a taxpayer's individual burden will correspond to his or her means, increasing or decreasing with the taxpayer's income.

> **a. Increase the Individual Income tax rate:** Increasing the current personal income tax rate from 3.0% to 5.0% would generate **$5.7 billion** in new state revenue annually.
> **b. Increase the Corporate Income tax rate:** Increasing the corporate rate from 4.8% to 8.0% would generate **$950 million** in new state revenue annually.

2. Expand the sales tax base to consumer services: Back in the 1930's when sales taxes were being designed, services were a relatively insignificant portion of the economy. Today, services are by far the largest sector of the Illinois state economy. In spite of this, Illinois exempts most services from the sales tax. Ignoring the largest and most rapidly growing sector of the state's economy is poor fiscal policy. In fact, Illinois has one of the most narrow sales tax bases in the country, taxing only 17 of 168 class categories of services. The national average is 55. Expanding the sales tax base to include consumer services (not business, education or health care services) could generate **$2.0 - $2.4 billion annually.**

3. Create a means test for the Illinois tuition tax credit: There currently is no income limit on the Illinois tuition tax credit. As a result, relatively affluent taxpayers have received by far the most benefits from this tax break. Taxpayers with incomes of $50,000 or more per year accounted for 77% of the tax relief in 2004. Taxpayers with incomes of $100,000 or more accounted for almost 40% of the credit. Limiting the credit to families earning $60,000 a year or less would preserve the credit for low- and moderate-income families while saving the state **$40-$45 million** annually.

4. Subject pension income earned over $75,000 to taxation: Illinois is one of only three states that exempts all pension income from taxation. Low- and moderate-income seniors work to make ends meet, and subsequently pay taxes on their wages. Affluent seniors, on the other hand, do not have to work and also avoid paying taxes on their pensions. Exclusion of all pension income costs the state over $800 million annually in new revenue. Subjecting pension income over $75,000 to taxation would generate **$200 million** in new revenue annually.

5. Eliminate or means-test the Property Tax Credit: The Property Tax Credit costs the state of Illinois over $400 million a year. The credit primarily benefits wealthy homeowners, as only 20% of individuals earning $25,000 a year or less own a home. Creation of a means-test for this tax credit would preserve the benefit for low- and middle-income families while saving the state an estimated **$200-$240 million** annually.

6. Examine corporate tax expenditures and loopholes: In FY 2005, Illinois gave corporations nearly **$1.3 billion** in the form of tax expenditures. Some expenditures are now outdated or no longer fulfill the purpose for which they were intended. The state should re-examine all corporate tax expenditures and retain those that still fulfill a legitimate purpose and eliminate those that do not. In addition, Illinois should re-examine the method by which it calculates corporate income tax liability:

- **Repeal the Single Sales Factor.** Illinois changed its method for determining the corporate income tax, from a three-part formula to the single sales factor. Under the single sales factor, corporate income taxable in Illinois is determined solely on the basis of a company's in-state sales. Under the prior method, in addition to sales, the value of a corporation's property and payroll in Illinois were considered. Under the single sales factor, large, multinational companies who have a strong presence (facilities and employees) in Illinois, and are therefore the largest beneficiaries of state services, receive major income tax cuts. Small mom and pop shops, who principally make all their sales in the state, receive no benefit. According to a report issued by then Illinois Comptroller, Republican Loleta A. Didrickson, 32 companies were projected to gain at least $1 million per year in tax savings. The result, a net tax revenue loss to the state and local governments that the Illinois Department of Revenue estimated reached **$96 million** in FY 2001 ($63M state and $33M local) (This is the last year the Department of Revenue analyzed the loss to the state). Single Sales Factor was "sold" as an economic development policy that would create thousands of manufacturing. Not only did it fail to create new jobs, Illinois has actually lost manufacturing jobs since single sales factor became law. Illinois is not alone in this experience. According to a national report on the subject authored by Michael Mazerov, all eight states that recently passed single sales factor have suffered significant revenue losses without experiencing any demonstratable economic development.
- **Reduce the Retailers Discount**. The Retailers Discount was enacted in 1959 to reimburse businesses for the burden of computing and collecting the state sales tax that applied to their sales. Under the statute, retailers keep 1.75% of the sales tax they collect. While this discount served a legitimate purpose in 1959, its value is questionable today. With computerized collection and accounting systems prevalent, the cost of collecting sales taxes, especially for large retailers, is built into software packages and is negligible. Twenty-four states do not provide any discounts for sales tax collection. Of the 26 that still have these outmoded discounts, 10 have capped the maximum discount. Capping the Illinois discount at 1.75% of the first $1 million in sales is a practical solution. This preserves the discount for small businesses while greatly reducing the cost of this tax expenditure. This sensible change will save **$80-100 million** annually.
- **Other Corporate Tax Expenditures (Annual Loss FY 2005)**
  Newsprint and Ink to Newspapers and Magazines Exemption: **$41 million**
  Manufacturing and Assembling Machinery and Equip Exemption: **$164 million**
  Sales of Vehicles to Automobile Rentors Exemption: **$43 million**
  Enterprise and Foreign Trade Zone Dividend Subtractions: **$2.4 million**
  Enterprise and Foreign Trade Zone High Economic Impact Business Exemption: **$37 million**
  Timely Filing and Full Payment Discount: **$28 million**

7. Eliminate public subsidies to the horse racing industry: Illinois currently gives this horse racing industry millions in tax breaks. Elimination of breaks would generate **$48 million**.

8. Expand the Sales Tax to include food: (Only if the increased tax burden on low-income families is off-set with a refundable credit). **Taxing food will eliminate unintended relief to the wealthy and generate significant new revenue for the state.** According to the fiscal year 2005 Illinois Comptroller's Tax Expenditure Report, the food, drugs and medical appliances expenditure cost Illinois **$1.3 billion** alone – making it the largest tax expenditure in the state. While the food exemption is intended to provide targeted relief to low-income families, in reality the vast majority of the tax savings go to wealthier families. In fact, only 18% of the value of the savings from exempting food accrues to households with income below $25,000. Including food in the sales tax base will eliminate a tax break being given to unintended recipients.

The best way to provide relief to moderate- and low-income Illinois families is to add food tax relief to existing refundable tax credits (for instance, expanding the state's Earned Income Tax Credit) or by creating a new refundable tax credit. Five states that currently tax food provide this type of recommended targeted relief.

9. Carbon emissions charge: Creating "cap and trade" system on carbon emissions similar to the one used in the Clear Air Act of 1990 in Illinois could generate about **$2 billion annually.** Additionally, it would decrease carbon emissions over time and generate dollars that could be devoted to energy efficient technologies. Because most of the cost to business would be passed on to consumers, it should be coupled with targeted relief to low and middle income families to eliminate potential regressive impacts.

10. Review federal definitions: The state's definition of "income" that is subject to taxation, for both individuals and corporations, is closely tied to the federal definition. This has a direct and negative impact on the state's ability to collect revenues when the Federal Government grants tax breaks. A review of federal definitions of Adjusted Gross Income for individuals and Taxable Income for corporations to determine if allowed deductions from those amounts make sense for Illinois.