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The Taxpayer Accountability and Budget Stabilization Act (P.A. 96-1496)

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1. Brief Summary. For decades, Illinois state decision makers shirked their fiscal responsibilities. Despite governing a state that was low spending, they consistently avoided raising the recurring tax revenue needed to maintain service levels from one year to the next. Instead, they irresponsibly relied on debt to pay for current services. So the state borrowed from financial institutions, diverted revenue that should have funded pensions to instead cover current services, and delayed making payments to providers for public services delivered under contract with the state.[1] By the lame duck session that was held this January, that fiscal malfeasance had finally accumulated to unmanageable proportions. The state faced a deficit in excess of 50 percent of its General Fund for core services, its bond rating was perilously close to being lowered to junk status, and its back-log of unpaid bills pushed over $8 billion. No matter what other actions it took to resolve its financial problems, the state would no longer be fiscally viable without significant new revenue.

Forced at last to face its need for new, recurring revenue, on January 13, 2011, the General Assembly passed and the Governor signed into law, the "Taxpayer Accountability and Budget Stabilization Act" (P.A.96-1496).[2] This legislation contained two solutions intended to address the state's ongoing General Fund structural deficits. On the one hand, it implemented income tax increases and other revenue enhancements estimated to generate $7.3 billion annually in new revenue. On the other, it instituted hard, annual spending caps that limit year-to-year growth in total General Fund expenditures (including some debt service, the pension payments and transfers out) to two percent (2%), until and including FY2015.

There are four major consequences of this legislation.

First, given the items included under the annual spending caps (like debt service and the increased payments required under the Pension Ramp[3]), even if the state made the maximum, aggregate expenditure allowable under the caps each of the next four fiscal years, it would still have to cut General Fund spending on current services like education, healthcare, human services and public safety in real terms, by at least $1.69 billion over that period, or an average of $560 million per year.

Second, even after accounting for the new revenue generated under the Taxpayer Accountability and Budget Stabilization Act—there will not be enough General Fund revenue available to spend up to the caps in Fiscal Years 2012 – 2015.

In fact, annual revenue will fall anywhere from $1.48 billion to $5.98 billion less than the annual aggregate spending caps established for the FY2012-FY2015 sequence. With most of the expenditures included under the cap consisting of hard costs like scheduled debt service and pension payments, program cuts will be even more significant than previously indicated.

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Third, the income tax increases created under the Act are reduced significantly in FY2015, creating a major funding shortfall of around $5.98 billion that year alone.

Fourth, even after accounting for the tax increases under P.A. 96-1496, Illinois will remain a low tax state nationally and in the Midwest.

2. Highlights of the Legislation. The Taxpayer Accountability and Budget Stabilization Act, which was made effective as of January 1, 2011, implements the following major changes to tax and spending policies in Illinois:

- It increases the *Illinois Personal Income Tax* rate from 3% to 5% commencing on January 1, 2011, and continuing until December 31, 2014. Commencing on January 1, 2015, and continuing until December 31, 2024, the rate declines from 5% to 3.75%. Commencing on January 1, 2025, and continuing thereafter, the rate declines from 3.75% to 3.25%.
- It increases the *Corporate Income Tax* rate from 4.8% to 7.0% commencing on January 1, 2011, and continuing until December 31, 2014. Commencing on January 1, 2015, and continuing until December 31, 2024, the rate declines from 7% to 5.25%. Commencing on January 1, 2025, and continuing thereafter, the rate declines from 5.25% to 4.8%.[4]
- It temporarily suspends the *Net Operating Loss* carry forward for corporations (not including S-corporations) from 2011 to 2014, but allows corporations to take any NOL they otherwise could have claimed during the suspension period, after said period expires (i.e. the tax break is not lost, merely deferred).
- It reinstates the *Illinois Estate and Generation-Skipping Transfer Tax* for estates of more than $2 million, as of 2011.
- It *limits state General Fund spending*, including statutory transfers, debt service, pension contributions and the Budget Stabilization Fund for Fiscal Year 2012 to $36.818 billion. Thereafter, it creates an annual General Fund spending cap which cannot in the aggregate exceed a 2% increase from the prior Fiscal Year, through and including FY2015. This results in aggregate General Fund spending limits of: $37.554 B in FY2013; $38.305 B in FY2014; and $39.072 B in FY2015. Included under these spending caps are: all General Fund appropriations for services; all pension payments to the five public employee pension systems required by law; some capital and all operational debt service; and all transfers out (such as the Local Government Distributive Fund).
- It does not fund any new or additional transfers to the Local Government Distributive Fund (LGDF)—which diverts 10% of all state income tax revenue to counties and municipalities based on population—from the increased revenue generated by the 2011 income tax increases. The Local Government Distributive fund will be funded solely from the revenue generated from that portion of the personal (3%) and corporate (4.8%) income tax rates that existed prior to the changes made to the personal and corporate income tax rates under P.A. 96-1496.

3. Even if the State Spends to the Maximum Limits Allowed Over the Next Four Fiscal Years, the Caps Will Force Real Cuts In Public Services. As Figure 1 shows, the spending limits enacted into law under the Taxpayer Accountability and Budget Stabilization Act are hard caps that will effectively prevent real increases in General Fund support of the four core services of education, healthcare, human services and public safety, after pension contributions and debt service are taken into account.[5]

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Figure 1 Probable Long-Term Spending Authority Shortfall for General Fund Service Expenditures (Dollars in Billions)												
Fiscal Year	Total Spending CAP	Incremental $ Available	Pension	Pension Payment Increase from Prior Year	Incremental Spending Authority Available for All Else	FY 2012 GFS Adjusted for ECI* and Pop Growth**	Increment Needed for ECI and Population Growth GFS	Minimum Revenue Shortfall	Year-to-Year % Change	Cumulative Revenue Authority Shortfall	% Cumulative
FY 2012	$36.82		$4.49			$27.19					
FY 2013	$37.55	$0.730	$4.86	$0.376	$0.354	$28.10	$0.916	**($0.562)**	**-2.%**	**($0.562)**	**-2.%**
FY 2014	$38.31	$0.760	$5.24	$0.376	$0.384	$29.05	$0.947	**($0.563)**	**-1.92%**	**($1.125)**	**-3.9%**
FY 2015	$39.07	$0.760	$5.615	$0.376	$0.384	$30.03	$0.979	**($0.595)**	**-1.98%**	**($1.72)**	**-5.7%*****

*ECI is projected at 2.7% per year through FY2015, based on the average, annual ECI over the five full years until and including December 31, 2010.
**Population growth estimate is provided by the Department of Commerce and Economic Opportunity.
***Final percentage line does not add up due to rounding.

Figure 1 shows that when the annual General Fund dollar amount of appropriations for services is adjusted for the Employment Cost Index (the best inflation measure for the mostly labor cost of providing public services) and projected population growth through FY2015, there will, at a minimum, have to be a cumulative $1.69 billion or 5.8% real (inflation adjusted) reduction in state spending over the FY2012 to FY2015 period.[6] This is because there will not be enough incremental spending availability under the annual caps to accommodate the increased cost of providing public services attributed to inflation and population growth—solely after accounting for scheduled increases in Pension Ramp funding. Obviously, to the extent debt service or Medicaid costs grow, availability under the spending caps will be further diminished.

As Section 4 of this Issue Brief demonstrates, the actual spending cuts will be more significant than indicated in Figure 1, because the state will not have sufficient revenue to spend up to the authorized caps.

4. Despite the New Revenue Generated under P.A. 96-1496, Illinois will not have Enough General Fund Revenue Available to Spend to the Maximum Amounts Permitted under the Spending Caps established for FY2012-FY2015. Figures 2 shows the new, annual revenue which the Governor's Office of Management and Budget (GOMB) estimates will be generated by the various changes to Illinois tax policy implemented under P.A. 96-1496.

Figure 2
Projected New Annual Revenue Under P.A. 96-1496

Item	New Annual Revenue to General Fund
Increase Personal Income Tax Rate from 3% to 5%	$6.05 B
Increase Corporate Income Tax Rate from 4.8% to 7%	$770 M
Decouple from the Federal Repeal of the Estate Tax	$182 *
Temporarily Suspend the Net Operating Loss Carry Forward for Corporations	$250 M
Annual Net to General Fund	**$7.252 B ****

* In FY2013 and FY2014, GOMB increases this estimate to $243 M.

**NOTE: in FY2011 GOMB estimates the aforesaid tax increases will generate $2.88 B in new General Fund revenue

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As significant and needed as the revenue enhancements in P.A. 96-1496 are, they still do not generate enough new revenue to allow the state to spend to the maximum amount authorized under the annual spending caps in place through FY2015, as detailed in Figure 3 below. Note the annual shortfall between available revenue and the spending cap reaches $6.5 billion in FY2015, the first year the tax increases under P.A. 96-1496 are scheduled to be rolled-back.

Note further that, commencing in FY2016, the temporary suspension of the Net Operating Loss carry-forward expires. This means that, at a minimum, the state will lose the $250 million in annual revenue generated by the NOL suspension thereafter. In all likelihood the cost in lost revenue will be somewhat greater, given that corporations may utilize NOL accrued but not taken during the FY2012-FY2015 suspension period.

Figure 3
Projected Annual Revenue Shortfalls Under Spending Caps
(Current $ Billions)

Revenues	**2012**	**2013**	**2014**	**2015**
State Own Source[1]	$21.98	$22.34	$22.98	$23.50
Federal[1]	$5.94	$6.29	$6.67	$7.07
Individual Income Tax[2]	$6.05	$6.22	$6.39	$2.40
Corporate Income Tax[3]	$0.77	$0.80	$0.84	$0.17
Estate Tax[4]	$0.18	$0.24	$0.24	$0.24
Suspension of Net Operating Loss Carryover[4]	$0.25	$0.25	$0.25	$0.25
Loss of Federal Medicaid Match[4]	**-($.20)**	**-($.30)**	**-($.40)**	**-($.40)**
Loss of Tobacco Litigation Proceeds[4]	**-($.14)**	**-($.14)**	**-($.14)**	**-($.14)**
Total Revenue Projected to be Available[5]	$34.83	$35.70	$36.83	$33.09
Annual Spending Caps	$36.82	$37.55	$38.31	$39.07
Annual Revenue Shortfall	**-($1.99)**	**-($1.85)**	**-($1.48)**	**-($5.98)**

Notes: See Appendix. Figures are rounded.

Unless decision makers are willing to create annual operating deficits ranging from $1.48 billion to $5.98 billion, it is unlikely spending will go up to the maximum authorized under the caps in any fiscal year through FY2015. The General Fund spending plan currently being suggested by the Governor acknowledges as much, since it does not hit the cap limit in any fiscal year between now and FY2015, as shown in Figure 4.

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Figure 4
Revenue Shortfall Under OMB Spending Plan
(Current $ Billions)

Fiscal Year	2012	2013	2014	2015
Total Revenue Projected to be available[1]	$34.83	$35.70	$36.83	$33.09
Current GOMB spending plan				
General Fund Spending on Services[2]	$27.18	$27.09	$26.66	$26.66
Statutory LGDF and other Transfers Out[2]	$1.87	$1.92	$1.97	$1.97
Debt Service[3]	$2.04	$2.00	$2.13	$2.13
Pension[4]	$4.49	$4.86	$5.24	$5.62
Total Proposed Spending	$35.58	$35.87	$36.00	$36.38
General Fund Surpluses/Deficits	**-($0.75)**	**-($0.17)**	$0.83	**-($3.29)**

Notes: See Appendix. Figures are rounded.

Note that, despite not spending to the cap limit in any of fiscal years 2012-2015, the Governor's currently suggested spending levels are none-the-less generally greater than the revenue that will be available to support said spending, resulting in annual deficits ranging from $170 million to $3.29 billion in all years except FY 2014. Part of this is explained by the Governor's current assumption that a proposed $1 per pack cigarette tax will become law, even though that proposal failed to pass the General Assembly during the January, 2011 lame-duck session.

5. Even after the Tax Increases Implemented Under P.A. 96-1496, Illinois Remains a Low-Tax State. Much political rhetoric has accompanied the tax increases Illinois passed under P.A. 96-1496. That is to be expected, given the hot-button nature of the subject. Typically, the vast majority of the attacks being made against Illinois—both by anti-tax groups and, interestingly, the Governors of Indiana, Wisconsin and New Jersey, have no basis in fact. As Figure 5 shows, even after the corporate income tax increase implemented under P.A. 96-1496, Illinois' corporate income tax rate remains lower than the corresponding corporate income tax rates in Indiana, Wisconsin and New Jersey.

Figure 5

Illinois: 7% until 2015, then 5.25%	
Midwest	**Other Big States**
Iowa: 6 – 12% (12% @ $250,000)	Pennsylvania: 9.99%
Indiana: 8.5%	New Jersey: 9%
Wisconsin: 7.9%	California: 8.84%
Missouri: 6.25%	New York: 7.1%
Kentucky: 4.6%	Florida: 5.5%
Michigan: 4.9%	

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True, Illinois local governments have a Personal Property Replacement Tax[7] corporations have to pay, that is assessed against 2.5% of corporate taxable income. But, as the name implies, this income-based tax replaces the old personal property tax assessed against certain corporate equipment and inventory. Each of Indiana, Wisconsin and New Jersey currently have local, corporate personal property taxes. So it would be an apples to oranges comparison to lump the Illinois Personal Property Replacement Tax in with the state income tax for comparison to other states, without accounting for the impact of their respective corporate personal property taxes. Moreover, Illinois' decision to replace the personal property tax with a tax based on income works to the benefit of businesses. After all, a personal property tax must be paid irrespective of corporate profitability, whereas an income-based tax is only payable once a business is profitable.

Figure 6

IL State Own-Source Revenue Under Neighboring State Revenue Shares FY2008 Current $ Billions

	State Own-Source Revenue as a Percentage of Personal Income	Increase or Decrease in IL GF Revenue if Illinois Had Equal State-Based Tax Burden as a Percentage of State Income
Illinois	7.6%	
Indiana	9.7%	+ $11.16 B
Iowa	9.7%	+ $11.16 B
Kentucky	10.7%	+ $16.48 B
Missouri	7.6%	$0
Wisconsin	10.1%	+ $13.29 B

Sources:
1) 2008 State Revenue as a Percentage of Personal Income, Federation of Tax Administrators, updated July 19, 2010.
2) Increases based on BEA 2008 Illinois Personal Income of $531.591 B

Bigger picture, Illinois remains one of the lowest overall taxing states in the nation—even after the tax increases under P.A. 96-1496. Note that, as Figure 6 shows, prior to the tax increase, Illinois was tied with Missouri for lowest state tax burden as a percentage of income in the Midwest.

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Unfortunately, comprehensive data to do a current evaluation of the impact of the recent Illinois tax increases is not available. However, even if the recent tax increase had passed in 2008 (the last year such comprehensive data were available), Illinois would remain lower tax than all its Midwest neighbors other than Missouri—as Figure 7 shows.

Note, Figure 7 imposes the full, FY2012 tax increases as if they had occurred four years ago, in 2008. This overstates the actual tax burden created in the Act, since personal income in Illinois is greater now than in 2008.

Figure 7

IL State Own-Source Revenue Under Neighboring State Revenue Shares FY2008 Current $ Billions if Passage of the 2011 Tax Increase Happened in 2008.

	Share Own-Source Revenue as a Percentage of Personal Income	Increase or Decrease in IL GF Revenue Revenue if Illinois Had Equal State-Based Tax Burden as a Percentage of State Income
Illinois*	8.8%	
Indiana	9.8%	$5.5
Iowa	9.7%	$5.0
Kentucky	10.7%	$10.5
Missouri	7.6%	($6.7)
Wisconsin	10.1%	$7.2

Sources:
1) 2008 State and Local Revenue as a Percentage of Personal Income, Federation of Tax Administrators, updated July 19, 2010.
2) Increases based on BEA 2008 Illinois Personal Income.
* This overstates the actual new tax burden.

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APPENDIX

Notes to Figure 3

1) FY 2012 to FY 2014 from OMB 1/20/2011 estimates. FY 2015 based on average growth of prior two years.

2) FY 2012 To FY 214 from OMB 1/20/2011 data. FY 2015 is pro-rated (.75/2=0.375) FY 2014 value.

3) FY 2012 To FY 214 from OMB 1/20/2011 data. FY 2015 is pro-rated (.24/2.2=0.205) FY 2014 value.

4) FY 2012 to Fy 2014 from OMB 1/20/2011 data. FY 2015 set equal to FY 2014.

5) Note that that revenue from proposed cigarette tax increase, deficit restructuring, and interfund borrowing
are not included as these bills authorizing these have not (as of 2/9/2011) been passed.

Notes to Figure 4

1) From Figure 3 above.

2) FY 2012 to FY 2014 OMB 1/20/2011 estimates. FY 2015 set equal to FY 2014.

3) From OMB 1/20/2011 estimates. This is a sum of debt service on existing capital, 2003 POB, and 2010 and 2011 PON.
FY 2015 set equal to FY 2014.

4) FY 2012 to FY 2014 from OMB 1/20/2011. FY 2015 set equal to FY 2014 plus FY 2014-FY 2013 increment.

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ENDNOTES

[1] For complete, detailed analysis of Illinois' long-term tax and spending policies, see CTBA"s report "FOF", available online at http://www.ctbaonline.org/New_Folder/Budget,%20Tax%20and%20Revenue/FINAL%20Funding%20Our%20Future-CTBA%20Report%2010.29.2010.pdf

[2] PA 96-1496, at: http://www.ilga.gov/legislation/publicacts/96/096-1496.htm

[3] The Pension Ramp became law in 1995, pursuant to Public Act 88-0593, to address Illinois's unfunding of public pensions. The Pension Ramp created a 45-year payment period, during which the state would make annually increasing contributions to the five public employee pension funds, to make up for Illinois' decade long practice of using the pension systems like a credit card, by funding current services with a portion of the employer contributions the state owed to the pension system. During the first 15 years of the Pension Ramp the employer contribution was set at levels which did not meet the full actuarially required payment. This back-loading of costs in the Pension Ramp creates significant pressure on the General Fund, and is why the Pension Ramp contributes materially to the state's ongoing General Fund deficits.

[4] The Personal Property Replacement Tax of 2.5% that is also applied to corporate income does not change.

[5] *Funding Our Future*, p. 9-10.

[6] Note that this is a conservative estimate as health care costs have historically risen much faster than the ECI plus population growth.

[7] The Personal Property Replacement Tax was established by Public Act 81SS1-1, during the special session of the 81st IL General Assembly.

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