Taxpayers' Federation of ILLINOIS

State and Local Taxes in Illinois: Issues and Trends

Illinois Association of County Board Members and Commissioners

February 19, 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

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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.

INSIDE THIS ISSUE

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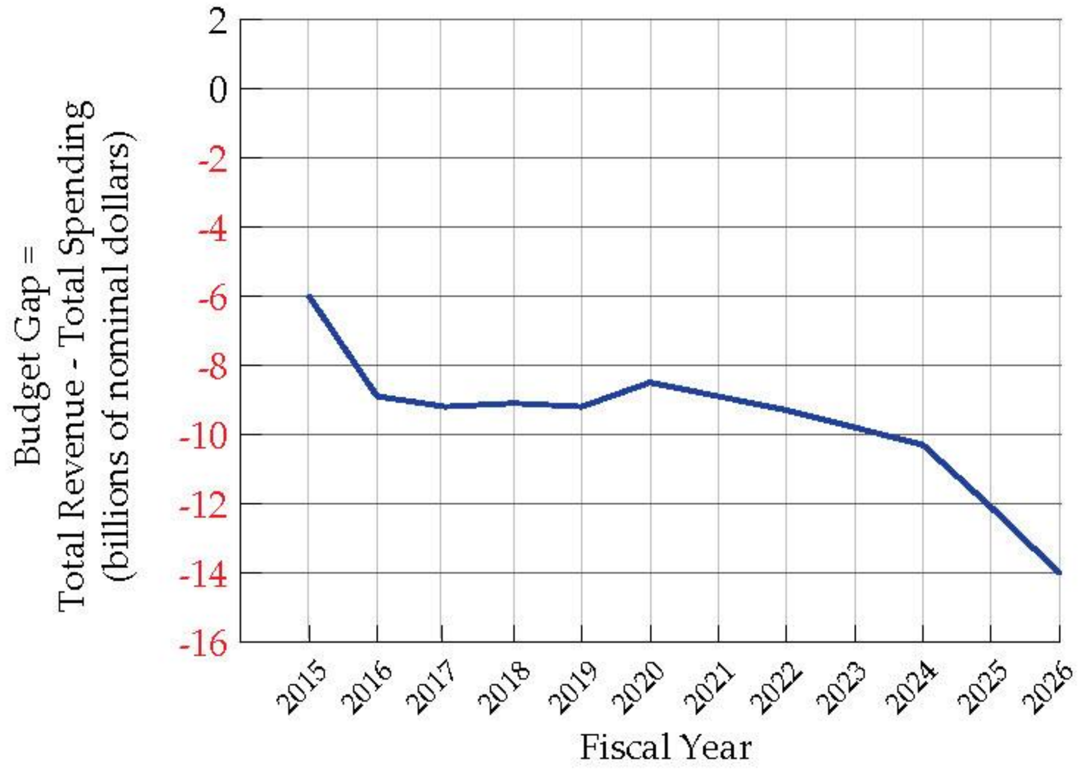
Depressing Chart-of-the-Day

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

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How to Fill a $6 Billion Hole?
(Or $1.5 Billion, or $9 Billion)

- Increase Revenue
- Cut Spending
- Magic

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Option One: Raise Taxes

- But 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%
  - 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

- Illinois exempts ALL retirement income from income tax

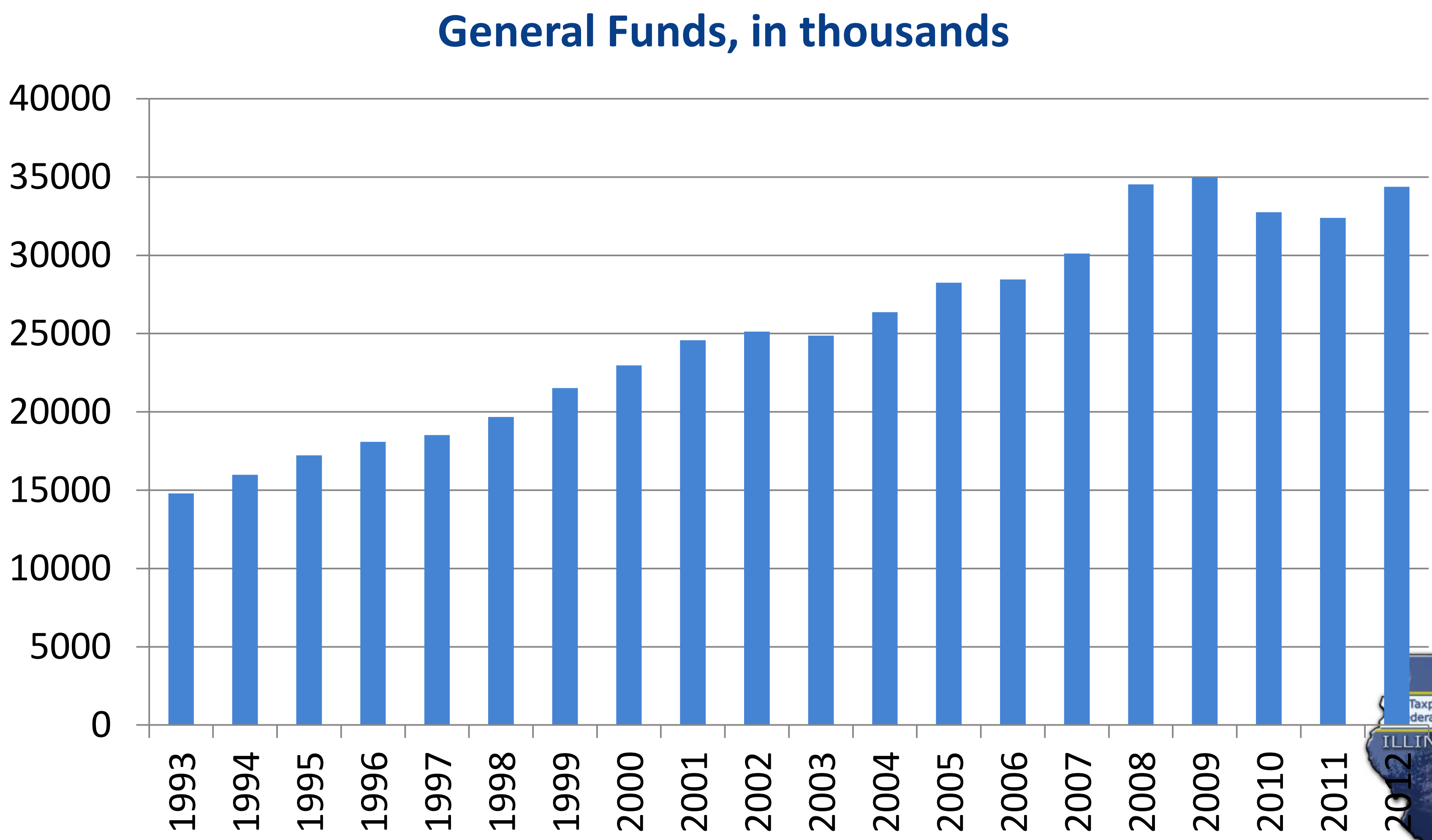
TFI Tax Burden Analysis--FY2012

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

Option Two: Cut Spending
Historic Spending in Illinois



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%

The 2016 Budget

- Governor Rauner's Proposal:
  - – No new taxes
  - – New pension plan—$2.2B
  - – Huge spending cuts, including--
    - higher education—31%
    - Medicaid—$1.5B
    - Some programs eliminated entirely
  - – ***not*** across-the-board X% reduction
  - – 50% reduction to income tax component of LGDF

Tax Issues Impacting Counties

- Property Taxes (PTELL)
- Sales Taxes (services, sourcing)
- Income Taxes

Rates: individuals: 5.0% →3.75%

corporations: 9.5% →7.75%

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

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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

Other Taxes—Top 10 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 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.

Sales Tax Issues to Watch

Remote (online) sales

- Sellers don't collect tax (Amazon started 2/1/2015)
- Customers owe, but seldom pay tax
- Federal and state efforts to level the playing field—so far, with limited success

Sourcing

- Where did a sale occur? Easy with over-the-counter; not so easy in complicated transactions
- Creative use of economic development agreements
- Lawsuits by DOR, RTA, others, challenge status quo
- New regulations; possibly new laws

Tax on Services

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“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

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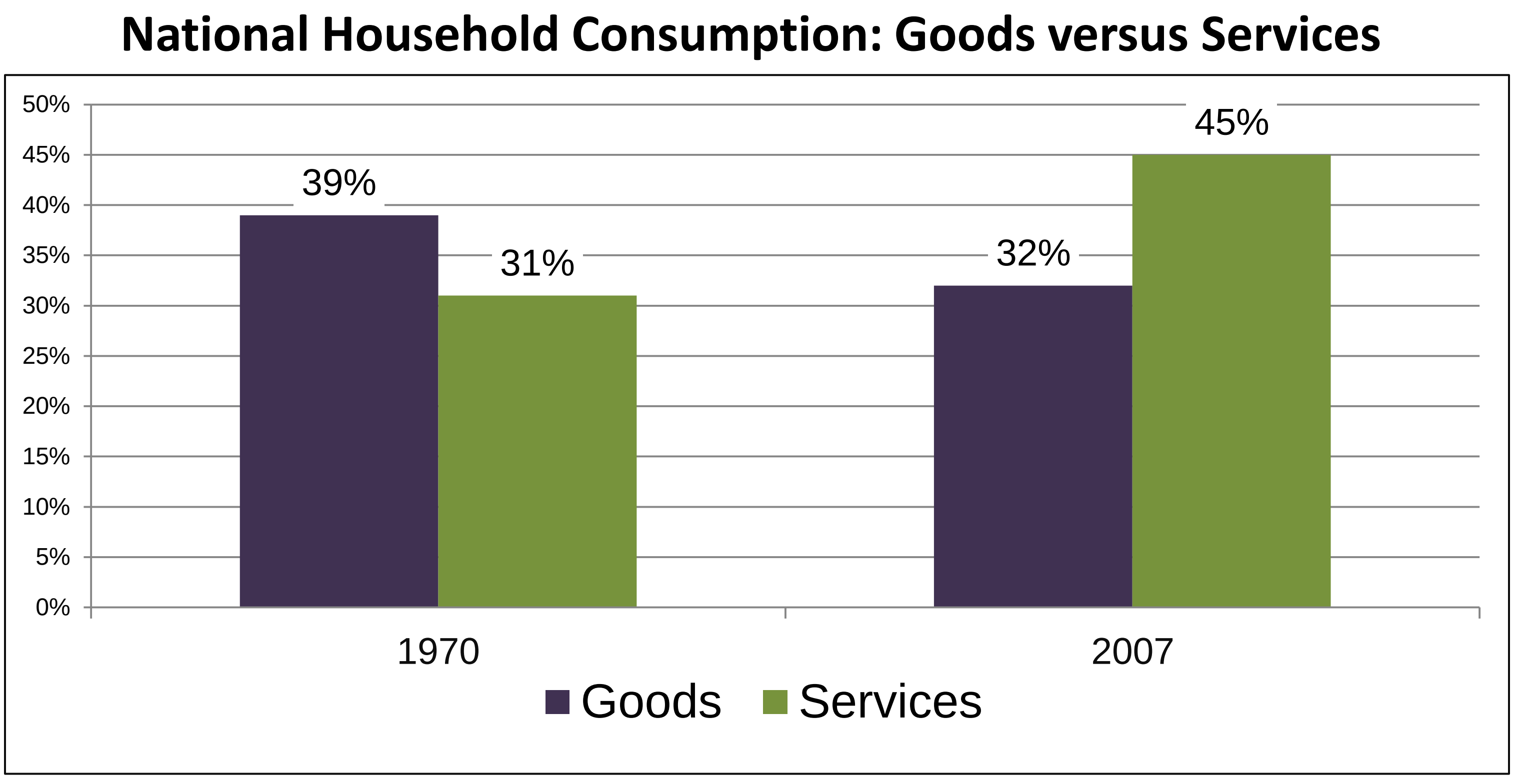
The Shift Towards a "Service Economy"



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

Tax Pyramiding

Basic Industry sells $100 worth of raw materials to Manufacturer : $5 tax → Manufacturer adds value and sells $200 product to an Integrator: $10 tax → Integrator adds value and sells $250 product to a whole-saler: $12.5 tax → Wholesaler adds value and sells $300 product to a retailer: $15 tax → Retailer adds value and sells $400 product to consumer: $20 tax

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

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Income Tax

Before 2011:

- Individual rate = 3%
- Corporate rate = 4.8%
- Counties received 10 percent of the income tax collected
- Allocated based on relative population in the unincorporated area of each county

2011 - 2014:

- Rates increased to 5% and 7%, respectively
- State kept the entire increase
- In 2012 county governments received $131.4 million.

Effective 1/1/2015:

- Partial Roll-back to 3.75% and 5.25%, respectively
- Locals still at pre-2011 levels

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).

Income Tax Issues

- Locals do not share in the increased tax rates.
- But—any new tax breaks reduce receipts

- World has changed since 1976 (Replacement Tax distribution basis)

- State has been slow to pay.

- Increasing tendency to use Replacement Tax for other spending – most recently stipends for county officials.

What Can TFI Do?

- Future articles:
  - Sales tax on services
  - Assessment quality
  - What else?
- Blue Book Update (County Government Law)
- *Illinois Illustrated* booklet

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