ILLINOIS CHAMBER
OF COMMERCE

Taxpayers' Federation of ILLINOIS

February 19, 2014

Dear Friends and Colleagues:

The underlying presumption in the debate over tax reform in Illinois has been that the use/abuse of tax incentives is the primary reason so few corporations pay Illinois corporate income tax. But some critical information has been missing from the discussion to-date—the evidence to support that presumption.

The attached report, *Probing Beneath the Surface*, answers the fundamental questions: Why do so few corporations have an Illinois corporate income tax liability? How significant is the impact of deductions and credits in eliminating tax liability?

Based on a series of Freedom of Information Act requests to the Department of Revenue for aggregated data off the corporate income tax returns (Form IL-1120 and Credit Schedule 1299), our study looks at the roughly two-thirds of Illinois corporate income tax filers that show no tax liability. The study covers tax years 2007 through 2011, a period which represents both highs and lows in the economic cycle. The answers we received challenge many of the underlying assumptions in the ongoing corporate tax reform debate. What we found:

1. **Federal taxable income (FTI) which is the starting point for computing Illinois tax liability is by far the primary factor in determining whether an Illinois filer will have an Illinois corporate income tax liability—not Illinois deductions or credits.** The most significant factor in determining whether a corporation would have an Illinois tax liability was whether or not that corporation showed federal taxable income (FTI) on line 1 of their Illinois return. In fact, over the 5 year period, 98.3 percent of corporations with negative FTI on line one of their Illinois return had no corporate income tax liability, while 88.5% with a positive FTI on line 1 had corporate income tax liability.

2. **In addition, Illinois corporate tax *deductions* play a very minor role in reducing a corporation's tax liability to zero even if the corporation does have a positive FTI.** The average number of returns filed showing no Illinois corporate income tax (Illinois CIT) liability over the 5 year period was 75, 517. Of those 75,517 filers, on average 4059 corporations had a positive FTI on line 1 of their Illinois return but no CIT liability. Only 17.8% of those returns initially showing FTI wound up with no tax liability after applying Illinois deductions.

3. **More specifically, the 2011 suspension of the Net Operating Loss Deduction did not have a significant impact in moving corporations with a negative FTI from a non-taxpaying status to a taxpaying status. It appears that the burden of the 2011 NOLD suspension was borne, for the most part, by taxpayers that were already paying corporate income tax.** Logically, if you have no income against which to apply a deduction, loss of the deduction will have little impact and the data bears that presumption out—the number of returns with negative FTI and no tax liability remains consistent despite the 2011 NOLD suspension. However, the data suggests that suspending NOLD's did create a tax liability for approximately 2000 filers (only 3% of total filers without a corporate income tax liability) that otherwise would have used their NOLD to offset positive income. It should be noted, however, that these corporations will still be able to use any unused NOLD's in future years when the suspension is lifted.