PROBING BENEATH THE SURFACE:

Understanding Why So Many Corporations Do Not Pay Illinois Corporate Income Tax

A report by JD Michael LLC
Funded by: Illinois Chamber of Commerce
Taxpayers' Federation of Illinois

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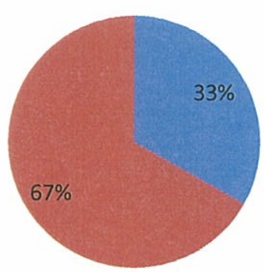
Two-Thirds of Corporations Don't Pay Tax in Illinois



2007 - 2011 Average

- Returns with Tax Liability: 37,402
- Returns without Tax Liability: 75,517

Source: Table 2-2

- The facts are undisputable
- The question is, WHY?

Answering the Question

- That "2/3 don't pay tax" statistic is frequently used to justify a variety of proposals, but never examined or explained
- TFI and the Chamber engaged JD Michael to dig deeper into the data for answers
- This Report is a starting point

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Methodology

- Freedom of Information Act requests to the Illinois Department of Revenue
- Line-by-line analysis of IL-1120 and 1299-D (the corporate income tax return and credits schedule)
- Goal: determine at what point corporations "fall out" of tax-payer to no-tax-payer status

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Corporation Income Tax Basics: Step One: Federal Taxable Income

Federal Gross Income

(-) Deductions

Federal Taxable Income (Line 30 of Federal Return)

(x) Federal Tax Rate

Federal Income Tax

(-) Federal Tax Credits

Total Tax Liability

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Corporation Income Tax Basics: Step Two: Illinois Tax Calculation

Federal Taxable Income ("FTI") (Line 30 of Federal Return)

(+) Illinois Addition Modifications

(-) Illinois Subtractions/Deductions

Illinois Base Income

Apportion Base Income

(-) Illinois Net Operating Deduction (NOLD)

Taxable Income x Tax Rate = Tax

(-) Credits

Illinois CIT Liability

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Things to Keep in Mind:

- **Scope of the Study**: Corporations without CIT liability. (Cannot use this data to evaluate particular income tax provisions because it does not include all corporations.)
- When we are talking about $ amounts shown in line 1 and subsequent additions and subtractions, we are generally talking about nation-wide income amounts *before* apportionment—**NOT tax $**.
- **Not all businesses pay CIT** (income earned by partnerships, S Corps, LLC's, LLP's, and sole proprietorships is generally subject to the individual income tax).

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Federal Taxable Income is the Driver

- 95% of corporations with no CIT liability had either negative or zero Federal Taxable Income
- 98% of corporations with negative Federal Taxable Income had no CIT liability
- 88.9% of corporations with positive Federal Taxable Income have a CIT liability.

Source: Tables 2-3 and 2-4

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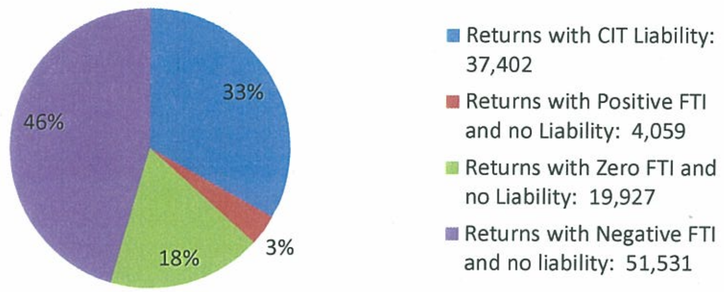
Looking at it Another Way:

2007 - 2011 Averages



Source: Table 2-2

There are still, on average, 4,059 returns with positive FTI but no tax liability—our review is not complete

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Which Modifications?

- Most common additions:
  - Federal Net Operating Loss (17% of returns with liability)
  - Special Depreciation (11%)

Both provisions are federal deductions disallowed for Illinois purposes because Illinois has enacted its own counterpart.

- Most common subtractions:
  - Special Depreciation (17% of returns with no liability)
  - Foreign Dividends Received (4%)
  - Tax Exempt Interest (2%)

Each is grounded in sound tax policy.

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