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2006 Illinois State & Local Business Tax Burden Study

Prepared for The Illinois Chamber of Commerce, The Chicagoland
Chamber of Commerce, and the Illinois Business Roundtable

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Executive Summary

The Illinois legislature is currently considering significant changes in the Illinois state and local tax system, including taxes paid by business. This report provides comprehensive estimates of the state and local taxes currently paid by business taxpayers in Illinois. This is critical information needed to evaluate Illinois tax policy options. This study updates Illinois business tax estimates prepared by Ernst & Young for fiscal year 2003.¹

State and local business taxes estimated in this study include the corporate income tax, corporate franchise tax, personal property replacement tax, and all of the “indirect” state and local taxes that are paid by Illinois business taxpayers, including property and sales and use taxes. These are the state and local taxes that are the legal liabilities of business taxpayers.

The following are key findings of the study:

- Illinois businesses paid \$29.1 billion in total state and local taxes in fiscal year (FY) 2006. To put this in perspective, business taxes accounted for almost 50% of the total state and local taxes collected by all Illinois state and local governments in FY2006.
- Illinois business taxes are rising faster than non-business taxes. Illinois state and local business taxes increased 37.6% -- by \$8.0 billion dollars -- from FY2002 to FY2006. Over the same four years, non-business taxes increased by 24.3%.
- As a result of faster growth in business taxes, the share of total Illinois state and local taxes paid by business increased from 47.3% to 49.8%.
- The single largest business tax in Illinois is the property tax, accounting for 38.6% of total state and local business taxes in FY2006. Unemployment and workers’ compensation taxes account for the next largest share at 17.4% of total business taxes. The sales and use tax paid on business input purchases follows with a 13.1% share.
- Corporation income and personal property replacement taxes, at \$2.4 billion, account for 8.2% of total Illinois state and local business taxes. Individual income taxes imposed on business income are 2.2% of total business tax collections.

¹2003 *Illinois State and Local Business Tax Burden Study* (March 2004). Study prepared by Ernst & Young for the Illinois Chamber of Commerce and the Chicagoland Chamber of Commerce.

- Illinois businesses pay a higher share of total state and local taxes than businesses in the neighboring states of Indiana, Kentucky, Missouri, Iowa and Wisconsin.
- Compared to the neighboring states, Illinois state and local business taxes impose a higher tax burden, measured by the ratio of business taxes to private-sector gross state product (the effective business tax rate) than the tax systems in the neighboring states.

The results of this study should assist citizens, legislators, tax administrators and the business community in evaluating tax policy proposals to address both short-run and long-run revenue needs and to promote stronger growth in Illinois jobs and income. The study provides the following insights that are important to keep in mind during this policy discussion:

- The combined Illinois state and local business tax burden is significant and rising. From an economic development perspective, Illinois policymakers should carefully evaluate the competitiveness of the entire state and local business tax structure. Any business tax proposals considered in response to the current state budget situation should be evaluated in the context of the state's longer-run business tax policy and economic development objectives.
- The estimates of the actual state and local taxes paid by Illinois business provided in this study are the beginning point for evaluating Illinois' tax competitiveness. However, to more fully understand Illinois' competitiveness, these estimates of taxes paid must be compared to the level of economic activity being taxed, such as business income or property values. These are the effective tax rates, taxes paid divided by the tax base, that are the most accurate estimates of business tax burdens imposed by Illinois state and local governments.
- In evaluating Illinois taxes on business, policymakers must focus on the entire system of state and local business taxes, not just one business tax, such as the corporate income and personal property replacement tax or the property tax.

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Overview

The Illinois legislature is currently considering significant changes in the Illinois state and local tax system, including taxes paid by business. This report provides comprehensive estimates of the state and local taxes currently paid by business taxpayers in Illinois, important information needed in this critical tax policy debate.

Citizens, legislators, and other policymakers are increasingly concerned about Illinois' ability to retain and attract jobs and new capital investment. An important first step in evaluating the competitiveness of Illinois' state and local tax system is identifying the state and local taxes that are currently being paid by businesses operating in Illinois. These are the state and local taxes that businesses are legally liable to pay.

Illinois' State and Local Business Taxes

This study provides estimates of the Illinois state and local taxes paid by business in FY2006. (See the appendix for a detailed description of the study's methodology.) The following state and local business taxes are included in the analysis:

- Property taxes on business property,
- State unemployment and workers' compensation insurance taxes,
- Sales, use and excise taxes paid by business (not consumers) on business purchases,
- Corporate income and personal property replacement taxes,
- Gross receipts taxes on utilities, insurance companies, and riverboat gambling, and
- Corporate and business license, franchise, and other taxes.

As shown in Table 1 and Figure 1, Illinois businesses paid \$29.1 billion in state and local taxes in FY2006. The single largest tax amount is, by far, the property tax, accounting for 38.6% of total state and local business taxes. The next largest category is unemployment insurance and workers' compensation taxes at 17.4%.²

Sales and use taxes on business purchases account for 13.1% of total Illinois state and local business taxes. Businesses pay an estimated 42% of the general sales tax in Illinois. Corporation income taxes, including personal property replacement taxes, total \$2.4 billion and account for

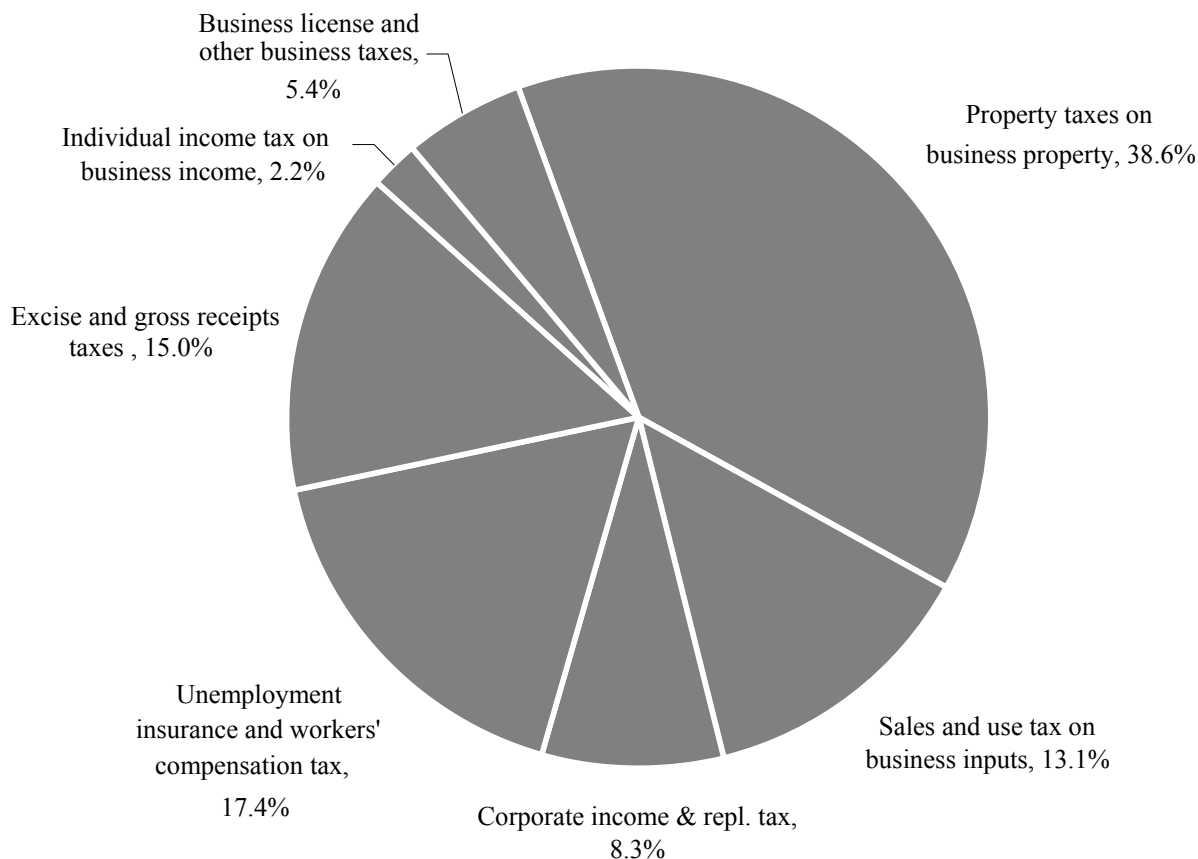
² The business tax estimates in Table 1 include workers' compensation taxes. These taxes were not included in the summary table in the FY2003 Illinois business tax study. Due to this difference, and several changes in the estimation methodology, the estimates in the FY2003 and FY2006 Illinois studies are not directly comparable. Workers' compensation taxes were not included in the Ernst & Young study, prepared in conjunction with the Council on State Taxation, *Total State and Local Business Taxes: 50-State Estimates for Fiscal Year 2006* (February 2007). Consequently, the estimates presented in this study for FY2006 are not directly comparable to the Illinois figures in the 50-state study. In addition, this study incorporates a significant revision made by the U.S. Census Bureau in the FY2002 Illinois corporate income tax figure reported earlier in the *Annual Survey of Governmental Finances*.

8.3% of total Illinois state and local business taxes. Individual income taxes imposed on business income are 2.2% of the total.

Table 1
Illinois State and Local Business Taxes, FY2006
(Dollars in Billions)

Business Tax	FY2006 Amount	% Total Business Taxes
Property taxes on business property	\$11.2	38.6%
Unemployment insurance & workers' comp. taxes	\$5.1	17.4%
General sales taxes on business inputs	\$3.8	13.1%
Public utility taxes	\$2.8	9.7%
Corporate income & personal property replace. taxes	\$2.4	8.3%
Excise taxes	\$1.2	4.2%
Business and corporate license	\$0.9	3.0%
Other business taxes	\$0.7	2.4%
Individual income tax on business income	\$0.6	2.2%
Insurance premiums taxes	\$0.3	1.1%
Total Business Taxes	\$29.1	100.0%

Figure 1
Composition of Illinois Total Business Taxes, FY2006



Trends in Illinois' State and Local Business Taxes

As seen in Table 2, total state and local business taxes increased by 37.6%, or \$8.0 billion, between FY2002 and FY2006. In comparison, non-business taxes grew only 24.3% over this four-year period, resulting in a combined growth rate for total state and local taxes of 30.6%. The strong growth in total business taxes over this period results from increases in most tax categories including corporate income and personal property replacement taxes (+74%), unemployment insurance and workers' compensation taxes (+54%) and property taxes (+38%), the largest component of state and local business taxes.

Table 2
Change in Illinois State and Local Business Taxes, FY2002 to FY2006
(Dollars in Billions)

Business Tax	FY2002	FY2006	% Growth FY02-FY06*	% of Total Business Tax Growth
Property taxes on business property	\$8.1	\$11.2	38.2%	39.0%
Unemployment ins. & workers' comp. taxes	\$3.3	\$5.1	53.5%	22.2%
General sales taxes on business inputs	\$3.2	\$3.8	19.3%	7.7%
Public utility taxes	\$2.4	\$2.8	20.2%	6.0%
Corporate income & personal property replace. taxes	\$1.4	\$2.4	73.5%	12.8%
Excise taxes	\$1.0	\$1.2	27.8%	3.3%
Corporate and business license	\$0.5	\$0.9	86.6%	5.1%
Individual Income Tax on Business Income	\$0.5	\$0.6	31.9%	2.0%
Insurance premiums	\$0.3	\$0.3	12.2%	0.4%
Other business taxes	\$0.6	\$0.7	19.6%	1.5%
Total Business Taxes	\$21.1	\$29.1	37.6%	100.0%
Total State and Local Taxes	\$44.7	\$58.4	30.6%	
Business Share	47.3%	49.8%	+2.5%	

*The percentage growth figures are calculated using the unrounded tax amounts.

The last line in Table 2 shows that the relatively strong growth in business taxes resulted in the share of total state and local taxes paid by business in Illinois increasing from 47.3% to 49.8%. The share of Illinois' taxes paid by business measures the relative importance of business and non-business taxes in Illinois' state and local tax system. It shows Illinois' reliance on state and local business taxes, but does not measure how heavily businesses are taxed in Illinois compared to the economic activity or base that is taxed, such as business net income or real and personal property values.

From a tax policy perspective, it is also important to look at the composition and growth rates of state taxes and local taxes separately as presented in Tables 3-A, 3-B, and 3-C. Table 3-A shows the level and composition, by tax type, of state and local taxes combined (from Table 1). Comparisons of Tables 3-B and 3-C show the important differences in the composition of Illinois business taxes at the state and local levels. At the state level, workers' compensation and unemployment insurance taxes have grown 53.5% in the past four years and are now the largest state business tax category. At the local level, the property tax accounts for almost 83% of local

business taxes. In terms of overall growth rates, Illinois business taxes at the local level grew almost as rapidly as state business taxes between FY2002 and FY2006.

Table 3-A
Illinois State and Local Business Taxes, FY2006
(Dollars in Billions)

Business Tax	FY2006	% Total Taxes	% Growth FY02-06
Property taxes on business property	\$11.2	38.6%	38.2%
Unemployment ins. & workers' comp. taxes	\$5.1	17.4%	53.5%
General sales taxes on business inputs	\$3.8	13.1%	19.3%
Public utility taxes	\$2.8	9.7%	20.2%
Corporate income tax	\$2.4	8.3%	73.5%
Excise taxes	\$1.2	4.2%	27.8%
Business and corporate license	\$0.9	3.0%	86.6%
Individual income tax on business income	\$0.7	2.2%	31.9%
Insurance premiums taxes	\$0.3	1.1%	12.2%
Other business taxes	\$0.7	2.4%	19.6%
Total Business Taxes	\$29.1	100.0%	37.6%

Table 3-B
Illinois State Business Taxes, FY2006
(Dollars in Billions)

Business Tax	FY2006	% State Taxes	% Growth FY02-06
Unemployment ins. & workers' comp. taxes	\$5.1	32.4%	53.5%
General sales taxes on business inputs	\$3.3	21.1%	17.7%
Corporate income tax	\$2.4	15.4%	73.5%
Public utility taxes	\$1.8	11.3%	17.2%
Corporate and business license	\$0.9	5.7%	86.6%
Excise taxes	\$0.7	4.6%	15.7%
Individual income tax on business income	\$0.6	4.1%	31.9%
Insurance premiums taxes	\$0.3	2.1%	12.2%
Other business taxes	\$0.5	3.3%	10.6%
Total Business Taxes	\$15.6	100.0%	37.8%

Table 3-C
Illinois Local Business Taxes, FY2006
(Dollars in Billions)

Business Tax	FY2006	% Local Taxes	% Growth FY02-06
Property taxes on business property	\$11.2	82.8%	38.2%
Public utility taxes	\$1.1	7.9%	25.6%
General sales taxes on business inputs	\$0.5	3.8%	30.4%
Excise taxes	\$0.5	3.7%	50.6%
Other business taxes	\$0.2	1.8%	42.3%
Total Business Taxes	\$13.5	100.0%	37.4%

Comparison with Selected Neighboring States

Compared to states against which Illinois competes for jobs and business investment, Illinois currently imposes the greatest tax burden, measured by either the share of total state and local taxes paid by business (Figure 2) or by business taxes as a share of private-sector gross state product (Figure 3).³ As explained in footnote 3, the business taxes in Figures 2 and 3 exclude Illinois' relatively high workers' compensation taxes. For this reason, this comparison most likely underestimates the size of the relative business tax burden in Illinois.

As shown in Figure 2, the business share of total state and local taxes in Illinois is higher than in all of the bordering states, exceeding the border-state average share by 10%. Figure 3 compares the ratio of business taxes to the overall level of private-sector gross state product (GSP) in each state. Based on this ratio, Illinois business taxes per dollar of economic activity are 13% higher than business taxes in bordering states. While these comparisons are aggregated over all types of state and local business taxes, they provide a beginning point for evaluating Illinois' current business tax competitiveness with neighboring states.

³ The comparison of state and local business taxes paid in Illinois with the four competitive states is based on the results of the Ernst & Young study, prepared in conjunction with the Council on State Taxation, *Total State and Local Business Taxes: 50-State Estimates for Fiscal Year 2006* (February 2007). The 50-state business tax estimates do not include workers' comp taxes. Therefore, the business tax estimates shown in Figures 2 and 3 for Illinois have been adjusted to remove this tax. Given the relatively high level of workers' compensation taxes in Illinois, these comparisons most likely underestimate the size of the relative business tax burdens in Illinois.

Figure 2
Business Share of State and Local Taxes, FY2006
 (Average for five other states = 43.5%)

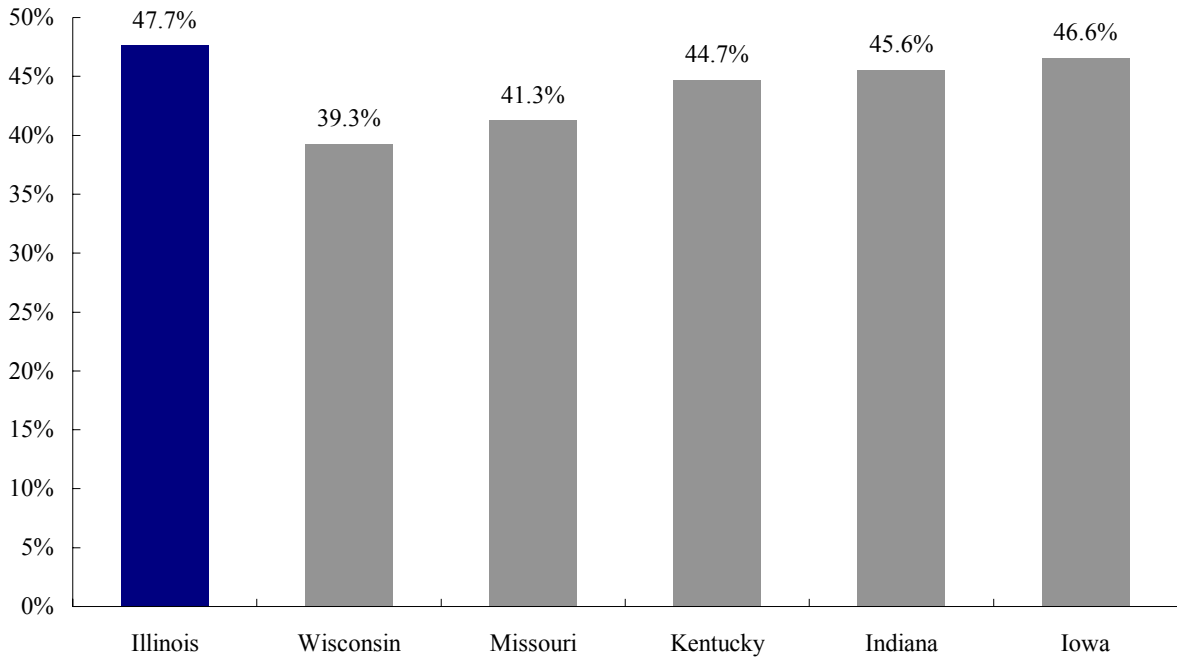
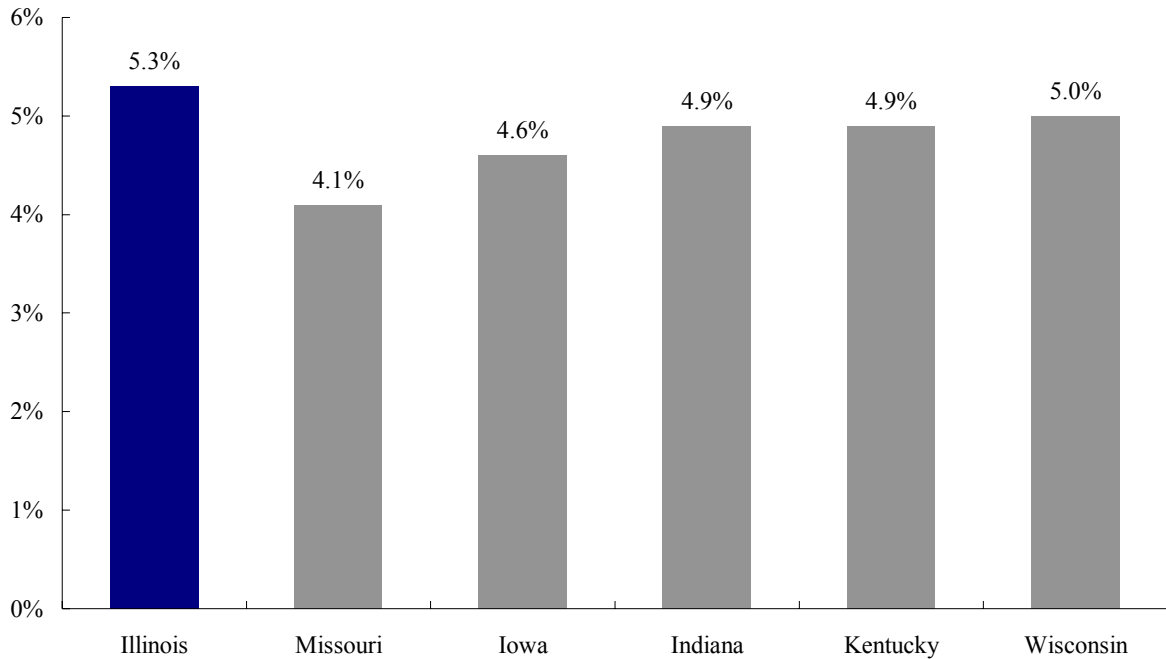


Figure 3
Business Taxes as Percentage of GSP, FY2006
 (Average for five other states = 4.7%)



Appendix: Description of Methodology

The Ernst & Young state and local business tax methodology used in this study follows the methodology developed in E&Y's series of 50-state business tax studies. The study uses detailed information describing the distribution of the retailers' and service occupation and use taxes and property taxes, as well as tax collection data, from the Illinois Office of the Comptroller and the Department of Revenue. Public tax and economic data sources are used to estimate the business share of each of 26 taxes reported by the U.S. Census Bureau for state and local levels of government, allowing the estimates to be compared across states.

Generally, business taxes include all taxes that are the legal liabilities of business, including taxes paid by corporations; non-corporate businesses, including partnerships and sole-proprietorships; non-profit entities; and taxes related to rental property owned by individuals. Sales and excise taxes paid by households are not considered to be business taxes, even though the taxes may be the legal liability of retailers and wholesalers. The individual income taxes paid by owners of pass-through business entities are included. The methodology described below was used to estimate business taxes in Illinois and in the comparison states.

Property Taxes

Property Taxes. Tax data describing tax levies or taxable assessed value by class of property were obtained from state and local government agencies. Taxes on residential rental property are treated as business taxes, similar to the treatment by the U.S. Commerce Department in measuring national income. Many states included residential rental properties in the residential property tax base. These states' household property tax share was adjusted to remove the rental residential housing from the household share and allocate it to the business share. Educational, farm, and not-for-profit entity property was allocated to business to the extent that it was taxed.

Sales, Gross Receipts and Excise Taxes

Retailers'/Service Occupation/Use Taxes. Retailers' and service occupation and use taxes paid by businesses on purchases of goods and services used in operations and production and on business purchases of capital equipment were estimated using the E&Y 50-state sales tax model and state collection data. The model estimates the total taxable business input purchases, business investment purchases, and personal consumption purchases that occur annually in each state to calculate the business share of total sales tax collections.

Gross Receipts Taxes on Insurance Premiums and Utility Receipts. Gross receipts taxes levied on insurance and utility companies were allocated to business because these taxes are often levied in lieu of generally applicable business taxes. Sales tax due on consumer purchases of these services, however, was not included in this category.

Motor Fuel Excise Taxes. Motor fuel taxes were allocated to the purchaser of the fuel, although many states require the wholesale distributor to remit such taxes. The percent of fuel consumed by business consumers was estimated using national input-output data describing the total value of petroleum refinery products used in commercial transportation activities and by household users. Purchases by other users of petroleum refinery products were excluded from the

calculations under the assumption that these users were purchasing non-motor-fuel petroleum products.

Hotel Occupation Taxes. The hotel occupation tax was allocated to business based on the estimated business share of total hotel expenditures. Using a methodology similar to that used in the sales tax model, national income, and product account data from the Bureau of Economic Analysis was used to allocate total hotel expenditures based on the relative sizes of intermediate purchases and personal consumption expenditures.

Other Selective Sales Taxes. Excise taxes on alcohol, pari-mutuels, and tobacco were considered household taxes and excluded from the business tax estimates. The remaining selective sales taxes were allocated 50% to business and 50% to households.

Income Taxes

Corporation Net Income and Corporate Personal Property Replacement Taxes. The corporate net income and replacement tax amounts are based on cash collections currently reported by the U.S. Census Bureau for each fiscal year. The growth in corporate tax collections from 2002 to 2006 was verified against the growth reported by the Illinois Office of the Comptroller in its annual report, *Illinois Detailed Annual Report of Revenues and Expenditures*. These taxes on corporate net income and personal property replacement were allocated entirely to business.

Individual Income Taxes. Business related individual income tax liabilities were estimated using data from the Internal Revenue Service describing the sources of Illinois resident income. Income derived from limited liability companies, partnerships, S-corporations, and farms was calculated as a share of total Illinois adjusted gross income. The individual income tax liability attributed to business equals the share of Illinois resident adjusted gross income derived from these business sources.

Asset Transfer Taxes

Documentary and Stock Transfer Taxes. These taxes on the transfer of ownership of an asset were allocated 94% to households and 6% to business. Only the 6% of these taxes that were estimated to arise from business acquisition of assets were considered paid by business.

Estate and Gift Taxes. All taxes on transfers of assets by gift or bequeath were assumed to be paid by individuals and were excluded from the business tax estimates.

License Taxes

Business/Corporate License Taxes. These taxes were allocated entirely to business. License taxes paid by businesses selling entirely to consumers were allocated to business because these taxes are the statutory liability of business.

Motor Vehicle License Taxes. Taxes on motor vehicle licenses and registrations were allocated to business based on U.S. Department of Transportation data describing the revenue for each type of vehicle by state. Automobile taxes and a portion of truck taxes were allocated to households, while all fees by weight, motor carrier fees, and other truck fees were allocated to business.

Driver's License and Hunting and Fishing License Taxes. These fees and taxes were allocated to households because they were generally the liability of individuals, even if directly related to the operation of a business or profession.

Unemployment Insurance and Workers' Compensation Taxes

These taxes were allocated entirely to business and include state unemployment insurance contributions and payments by employers to the Illinois Workers' Compensation Commission (formerly Illinois Industrial Commission).

Other Taxes

This category contains all taxes not listed above.

Economic Measures

Economic activity is measured by private-sector, gross state product. This is equivalent to current-year, state private-sector value added or, equivalently, payments to labor and capital from current production.