



PROBING BENEATH THE SURFACE:

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

JD Michael LLC

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Executive Summary

The Illinois Chamber of Commerce (ICC) and the Taxpayers' Federation of Illinois (TFI) jointly commissioned JD Michael, a Springfield-based consulting firm, to conduct a study on why a significant number of corporations do not incur an Illinois Corporate Income Tax (CIT) liability.

The Illinois Department of Revenue (IDOR) is the repository of taxpayer information required to conduct data-driven analyses of Illinois CIT. This report is based on information obtained from IDOR under the Freedom of Information Act (FOIA). Information for 2007 through 2011 was requested as that period represents almost a full business cycle, with 2007 the peak and 2009 the trough. We received data for all lines on the IL-1120 return up to the lines used to calculate apportionment of income to Illinois. Data from the remaining lines on the return were deemed by IDOR not to be clean and as such our FOIA request for these lines was denied.

Our approach is, within the limitations of the data, to walk down the Illinois 1120 tax return data for corporations that do not have a CIT liability to determine, when possible, what factors contribute to not having a tax liability.

The Illinois' corporate tax return starts with FTI and that is the most important factor determining Illinois tax liability. Based on our research, we find that over the study period 95 percent of Illinois' C-corporations that did not have a CIT liability had either zero or negative Federal Taxable Income (FTI).

We find that the role of Illinois modifications to FTI plays a limited role in explaining why firms do not have an Illinois CIT liability, particularly for returns with negative FTI. Eighty-two percent of returns with positive FTI have positive business income after accounting for Illinois modifications. This figure is 56.5 percent for returns with zero FTI and 1.6 percent of returns for those with negative FTI.

The data did not allow us to determine the specific impact of apportionment and Illinois Net Operating Loss Deductions (NOLDs) on income allocated to Illinois for tax purposes. However, the data do suggest that of the 14,010 returns with positive business income prior to apportionment, 13,878 moved into a no tax liability situation after apportionment and accounting for Illinois NOLDs.

Finally, the role of Illinois tax credits on Illinois tax liability was examined and found to be minimal. The data suggest that on average 132 returns use credits to move into a no tax liability situation (0.2 percent of total returns with no CIT liability).

Having indicated the various limitations to our analysis, we remain confident that this report yields some very important results for Illinois that heretofore have not been presented.

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Introduction

There has been much discussion in the media about businesses that do not pay any Corporate Income Tax, both at the federal and state level.¹

“Two-thirds of the corporations operating within our state’s borders, however, pay no Corporate Income Tax at all to the State of Illinois.”² This editorial goes on to say that (we) don’t know why these businesses do not pay Corporate Income Tax. To quote directly, “without that information it’s difficult to know whether they aren’t paying taxes as a result of legitimate deductions – that is to say, deductions that ultimately benefit our state – or simply because they’re tax dodgers who are shirking their duties by gaming the system.”³

In response to these and other statements the Illinois Chamber of Commerce (ICC) and the Taxpayers’ Federation of Illinois (TFI) jointly commissioned a study that would attempt to shed light on why a significant number of corporations do not incur an Illinois Corporate Income Tax (CIT) liability. The intent of the report is to answer the question of why corporations pay no Illinois CIT and to help inform legislators, other elected officials, and policy-makers as they consider the Fiscal Year 2015 budget and address the reduction in the temporary Corporate Income Tax rate increase scheduled for January 2015.

The Illinois Department of Revenue (IDOR) is the repository of taxpayer information required to do analysis of income taxes in Illinois. ICC and TFI crafted and submitted a Freedom of Information Act Request (FOIA) to IDOR asking for IL-1120 line-by-line aggregated data for C-corporations that did not have a tax liability. The request asked for this information to be disaggregated by Federal Taxable Income (FTI) status – those with positive FTI, zero FTI and negative FTI. Unfortunately, citing problems with data quality, IDOR denied part of the FOIA request relating to information regarding how much income firms apportion to Illinois. As a result there is a gap in the IL-1120 line-by-line analysis contained in this report.

Section 1 discusses the data and methodology used in this report.

Section 2 examines the relationship between FTI status and CIT liability.

Section 3 explains and analyzes various modifications made to FTI to arrive at Business Income. Business Income is the income amount that firms then apportion based on how much business activity they conduct in Illinois as a percent of business activity in the U.S. Illinois’ tax code uses sales as a measure of business activity.

Section 4 further refines information on FTI, income tax modifications, and business income by examining the data by FTI status (positive, zero, and negative).

Section 5 contains a discussion of how Business Income is used as the base to apportion income to Illinois and how a firm arrives at net income allocated to Illinois – the base to which

the tax rate is applied. As indicated above, hard data on these steps was not provided by IDOR. As a result we have to make inferences on what impact apportionment may have on the number of firms who have no net income allocated to Illinois.

Section 6 examines Schedule 1299-D income tax credit data and makes observations on what credits are taken most frequently and their impact on Illinois tax liability.

The report concludes with a summary of findings and recommendations to further assist policy makers as they examine CIT policy in Illinois.

Section 1

Data and Methodology

The Illinois Department of Revenue (IDOR) has databases that contain information contained on specific lines of the IL-1120 tax return) that are captured by IDOR.⁴ The IL-1120 is the annual Corporate Income Tax (CIT) return. This information forms the core for all CIT statistical analysis conducted by the department, with the exception of annual revenue forecasting. Obviously, IDOR is in a position to do very sophisticated research as they have access to individual taxpayer records. Outside groups such as the Center for Tax and Budget Accountability (CTBA), the Illinois Chamber of Commerce (ICC), Illinois Policy Institute (IPI), the Taxpayers' Federation of Illinois (TFI), and others are more limited in the analysis they can produce as they cannot be privy to confidential taxpayer information.

In order to address the recently heightened debate, the ICC and the TFI asked IDOR for information that would meet confidentiality requirements but would help shed light on why many corporations do not have an Illinois CIT liability. As a consequence of the aggregate nature of the data request, the subsequent analysis does not examine specific companies and how their tax liability varies over the 5-year period, but rather looks at companies in aggregate who do not have an Illinois income tax liability on an annual basis from 2007 through 2011.

The report is based on information obtained from IDOR under the Freedom of Information Act (FOIA). Information for five years, 2007 through 2011, was requested as that period represents almost a full business cycle, with 2007 the peak and 2009 the trough. The initial FOIA, submitted on September 18, 2013, requested annual IL-1120 tax return information by line item for C-corporations that had zero CIT liability, broken down by returns with negative, zero, and positive Federal Taxable Income (FTI). FTI (Line 1 of the IL-1120) is the starting point for determining Illinois Taxable Income. Ideally, 2012 would have been included in our request. However, it was not available.

After meeting with IDOR representatives to discuss the initial FOIA request, at which department staff indicated IDORs data system is not designed to cleanly aggregate line-by-line data and that some information would have to be examined return-by-return to verify its accuracy, the ICC and TFI modified the original request to include only information above the apportionment line on the IL-1120.⁵ We received information from our revised FOIA on November 1, 2013.

We had anticipated receiving additional information from IDOR based on our belief that subsequent FOIA requests could be filled if they were crafted more narrowly and asked for fewer years of data. However, this proved not to be the case; our third FOIA request submitted on November 18, 2013 was officially denied by IDOR on December 23, 2013 (see Appendix A).

The report starts with an analysis of tax return information prior to apportionment for C-corporations without a tax liability for 2007-2011 and then skips to an analysis of tax credits. The information for the tax credit section of the report is based largely on information obtained from Schedule 1299-D. Schedule 1299-D contains data on income tax credits claimed by type of credit. Because IDOR denied our FOIA request, we were unable to analyze the impact of apportionment and Net Operating Loss Deductions (NOLDs) on corporations that did not pay tax. It should be noted that we found what we thought were anomalies in the data and asked IDOR to investigate.⁶ Having indicated the various limitations to our analysis, we remain confident that this report yields some very important results for Illinois that heretofore have not been presented by IDOR or any other research group.

Our approach to this analysis is, within the limitations of the data, to walk down the IL-1120 tax return data for corporations that do not have a CIT liability to determine, when possible, what factors contribute to them not paying tax.

Section 2

Overview of 2007 through 2011 IL-1120 Returns

Table 2-1 illustrates that the total number of IL-1120 filers has been steadily decreasing throughout the study period. In absolute numbers, there are 9,786 (8.3 percent) fewer filers in 2011 compared to 2007. This decrease is offset by steady increases in the number of Illinois S-Corporations.⁷

Table 2-1: Distribution of All Returns by Federal Taxable Income (FTI) Status

Tax Year	Positive FTI	Zero FTI	Negative FTI	Total Returns
2011	32,337	23,771	52,479	108,587
2010	33,047	25,685	51,756	110,488
2009	32,503	24,307	54,180	110,990
2008	37,314	25,566	53,279	116,159
2007	40,929	26,970	50,474	118,373

Corporate Income Tax Returns with No Tax Liability – Positive, Zero, or Negative Federal Taxable Income Prior to Apportionment⁸

The first observation to be made is that over the five year period, on average, one-third of Corporate Income Tax (CIT) filers had an Illinois tax liability compared with two-thirds that did not (Table 2-2). At first blush, this statistic seems alarming and has been represented as such in the media.

In terms of percent, IL-1120 filers without a tax liability varied annually from 59.5 percent to 70.3 percent of total filers over the study period. As shown in Table 2-2, the vast majority of C-corporations without a tax liability has either negative or zero Federal Taxable Income (FTI).

The total number of filers without a tax liability was relatively consistent through the business cycle until 2011. This 2011 result may be a result of Illinois suspending the use of Net Operating Loss Deductions (NOLDs) imposed in 2011. Further research should be conducted to determine the impact of the NOLD suspension on CIT liability. Data indicate that while the percent of filers with negative FTI has remained relatively constant during the study period, the percent of filers with positive and zero FTI and no tax liability in Illinois fell significantly in 2011.

Table 2-2: Number of Returns with No CIT Liability by FTI Status

Tax Year	Positive FTI With No Tax Liability	Zero FTI With No Tax Liability	Negative FTI With No Tax Liability	All Returns with No Tax Liability	Total Returns	Percent of C-Corps With No Tax Liability
2011	2,367	10,737	51,517	64,621	108,587	59.5%
2010	4,494	21,593	50,901	76,988	110,488	69.7%
2009	3,890	20,959	53,141	77,990	110,990	70.3%
2008	4,400	22,358	52,146	78,904	116,159	67.9%
2007	5,145	23,987	49,950	79,082	118,373	66.8%
Average	4,059	19,927	51,531	75,517	112,919	66.9%

Digging behind the headlines - of those companies not having an Illinois CIT liability, on average over the five year period, 69 percent have negative FTI while 26 percent have a zero FTI (Table 2-3). The remaining five percent of firms with no tax liability have positive FTI. This five percent represents 4,049 returns (3.6 percent of all returns filed).

Table 2-3: Distribution of Returns with No Tax Liability by FTI Status

Tax Year	Positive FTI	Zero FTI	Negative FTI	Total
2011	4%	17%	80%	100%
2010	6%	28%	66%	100%
2009	5%	27%	68%	100%
2008	6%	28%	66%	100%
2007	7%	30%	63%	100%
Average	5%	26%	69%	100%

Finding 1: Ninety-five percent of the corporations with no Corporate Income Tax liability had either negative or zero Federal Taxable Income. Federal Taxable Income is Line 1 of the IL-1120.

Almost all companies with negative FTI (98.3 percent) do not incur an Illinois CIT liability (Table 2-4). The percent of firms with zero FTI and no tax liability averaged 78.9 percent over the period, while the vast majority of firms with positive FTI (88.5 percent) did incur an Illinois tax liability.

Table 2-4: Percent of Returns in Each FTI Status with No CIT Liability

Tax Year	Positive FTI-No Tax Liability	Zero FTI-No Tax Liability	Negative FTI-No Tax Liability
2011	7.3%	45.2%	98.2%
2010	13.6%	84.1%	98.3%
2009	12.0%	86.2%	98.1%
2008	11.8%	87.5%	97.9%
2007	12.6%	88.9%	99.0%
5-Year Average	11.5%	78.9%	98.3%

Finding 2: Federal Taxable Income (Line 1 on the IL-1120 return) is the driving factor behind Illinois Corporate Income Tax liability. For 2007 through 2011, on average 98.3 percent of corporations with negative Federal Taxable Income had no Illinois Corporate Income Tax liability while 88.5 percent with positive Federal Taxable Income had a Corporate Income Tax liability.

Summary

The overview of CIT return data provided above demonstrates that FTI status is the most significant factor in explaining whether or not C-Corporations have an Illinois CIT liability. Less than 2 percent of firms with negative FTI have an Illinois CIT liability, compared with 88.5 percent of firms with positive FTI.

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Section 3

Illinois Modifications to Federal Taxable Income

In this section of the report we examine how Illinois' modifications to Federal Taxable Income (FTI) affect Illinois Corporate Income Tax (CIT) liability. Modifications include: additions, subtractions, nonbusiness income, and business income from estates, trusts and non-unitary partnerships. We use two different units of analysis — number of firms and the dollar value associated with available line items. Note that the values associated with various modifications are pre-apportionment income amounts.

Illinois Addition and Subtraction Modifications

In terms of number of firms, Table 3-1 illustrates the frequency with which particular lines on the IL-1120 were completed for firms with no tax liability during the study period. Over the study period, as noted in Table 2-2, the annual average number of firms with no tax liability was 75,517.

Table 3-1: Annual Average Number of Returns with Illinois Addition Modifications to FTI

	Percent of Firms (annual average between 2007 and 2011)	Number of Firms (annual average 2007-2011)
Net Operating Loss Deduction from the U.S. 1120 (Line 2)	17%	12,597
Illinois Special Depreciation Addition (Line 5)	11%	8,237
Illinois Income and Replacement Tax Deducted in Arriving at FTI (Line 4)	7%	5,295
Other Additions from Schedule M (Line 8)	3%	2,319
State, Municipal and Other Interest Income Excluded from FTI (Line 3)	2%	1,224
Distributive Share of Additions (Line 7)	0.3%	211
Related Party Expense Addition (Line 6)	0.1%	95

Note: Complete Information for the related-party expense addition was available for 4 of the 5 years.

Table 3-2: Annual Average Value of Illinois Addition Modifications to FTI

	Total Annual Average Value (\$)	Annual Average Value Per Return (\$)
Net Operating Loss Deduction from the U.S. 1120 (Line 2)	\$53,853,130,272	\$4,274,940
Illinois Special Depreciation Addition (Line 5)	\$40,814,899,027	\$4,954,948
State, Municipal and Other Interest Income Excluded from FTI (Line 3)	\$9,969,333,616	\$8,142,220
Other Additions from Schedule M (Line 8)	\$4,534,024,028	\$7,381,999
Related-Party Expense Addition (Line 6)	\$24,020,511	\$252,184

Note: Complete Information for the related-party expense addition was available for 4 of the 5 years.

Table 3-1 and Table 3-2 provide annual average descriptive statistics for Illinois additions. The Federal Net Operating Loss Deduction (NOLD) is the largest both in terms of number of returns adding this item back on the Illinois returns and its total annual average value prior to apportionment. The U.S. Internal Revenue Service (IRS) permits corporations to deduct NOLDs for federal tax purposes. Illinois uses FTI as the starting point for calculating Illinois CIT liability. In order to apportion an appropriate percent of a corporation's nationwide losses, the Illinois tax code requires that the federal NOLD is first added back and then, based on a corporation's apportionment factor, part of this is allowed as an Illinois deduction. Note, however, this Illinois deduction was suspended in tax year 2011. Unfortunately our request for specific information on Illinois NOLDs was denied by IDOR.

Table 3-3: Annual Average Number of Returns with Illinois Subtraction Modifications to FTI

	Percent of Firms (annual average between 2007 and 2011)	Number of Returns (annual average 2007-2011)
Illinois Special Depreciation Subtraction (Line 18)	17%	12,650
Foreign Dividend Subtraction (Line 17)	4%	3,202
Interest Income from U.S. Treasury and Other Exempt Federal Obligations (Line 10)	2%	1,253
Other Subtractions from Schedule M (Line 21)	2%	1,165
Distributive Share of Subtractions (Line 20)	0.3%	236
Related Party Expenses Subtraction (Line 19)	0.2%	183

Note: Complete information was available for Distributive Share of Subtractions for 4 out of 5 years and for 2 out of 5 years for Related Party Expenses Subtraction. Enterprise zone, rivers edge zone and high impact business dividend and interest subtraction; contributions subtraction, and contributions to certain job training projects are excluded from this table as only 1 or in some cases no annual information was provided by IDOR because of confidentiality criteria.

Table 3-4: Annual Average Value of Illinois Subtraction Modifications to FTI

	Total Annual Average Value (\$)	Annual Average Value Per Return (\$)
Foreign Dividend Subtraction (Line 17)	\$72,204,835,210	\$22,552,735
Illinois Special Depreciation Subtraction (Line 18)	\$36,109,095,380	\$2,854,519
Interest Income from U.S. Treasury and Other Exempt Federal Obligations (Line 10)	\$13,914,756,315	\$11,101,609
Other Subtractions from Schedule M (Line 21)	\$3,331,184,288	\$2,859,386
Distributive Share of Subtractions (Line 20)	\$13,991,830	\$76,458
Related Party Expenses Subtraction (Line 19)	\$834,650	\$3,533

Note: Complete information was available for Distributive Share of Subtractions for 4 out of 5 years and for 2 out of 5 years for Related Party Expenses Subtraction. Enterprise zone, rivers edge zone, and high impact business dividend and interest subtraction; contributions subtraction, and contributions to certain job training projects are excluded from this table as only 1 or in some cases no annual information was provided by IDOR because of confidentiality criteria.

Table 3-3 and Table 3-4 provide annual average descriptive statistics for Illinois subtraction modifications to FTI. The Illinois Special Depreciation Subtraction is the largest in terms of number of returns while the Foreign Dividend Subtraction is the largest in terms of annual

average value prior to apportionment. Due to their magnitude these two Illinois subtractions warrant special attention.

At the federal level, a credit to avoid double taxation is provided to corporations that receive dividends paid by foreign subsidiaries. Most states provide a deduction for foreign dividends received, but the deduction is not always 100 percent of the dividends received.⁹ In such cases, the state tax on the foreign dividends depends not only on the state-specific dividends received deduction, but also on the state tax rate and the taxpayer's apportionment percentage.¹⁰ Illinois provides a 100-percent deduction for dividends received from a wholly owned foreign corporation. In addition, the Illinois deduction is reduced to 80 percent for a less-than-80-percent-owned foreign corporation, and further reduced to 70 percent for a less-than-20-percent-owned foreign corporation. Put in place to avoid double taxation and be consistent with the IRS, the Illinois Foreign Dividend Subtraction, with an estimated pre-apportionment value of \$72.2 billion, is the largest modification to FTI on the IL-1120.

The Illinois Special Depreciation subtraction (and its counterpart, the Illinois Special Depreciation addition) was introduced as a way to decouple from federal tax provisions. Given that the starting point of the IL-1120 is FTI, the state is automatically coupled with federal tax changes. The Illinois Special Depreciation Subtraction and Addition decouples Illinois from federal "bonus depreciation". The intent is to reverse the effects of federal "bonus depreciation" and disallow businesses from depreciating their assets more rapidly than traditional depreciation schedules allow.

However, the Illinois law is drafted in such a way that it is not an automatic decoupling, but applies only to two specific bonus depreciation rates: 30 percent or 50 percent. As a result, Illinois was decoupled from federal "bonus depreciation" between September 10, 2001 and before January 1, 2005 and during 2008 through 2010. However, Illinois was not decoupled from the 100 percent bonus depreciation allowed under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

Table 3-5: Illinois Special Depreciation Additions and Subtractions Modifications

	2007	2008	2009	2010	2011
Returns with Special Addition	4,448	10,658	11,728	9,805	4,547
Value of Special Addition	\$3,733,620,699	\$30,082,510,674	\$65,929,810,690	\$52,501,385,218	\$51,827,167,886
Special Addition Per Return	\$839,393	\$2,822,529	\$5,621,573	\$5,354,552	\$11,398,102
Returns with Special Deduction	14,057	15,525	16,692	16,031	994
Value of Special Deduction	\$12,613,955,273	\$15,210,672,460	\$44,696,835,662	\$43,779,129,233	\$64,244,884,272
Special Deduction Per Return	\$897,343	\$979,753	\$2,677,740	\$2,730,904	\$64,632,680

Table 3-5 illustrates how the absolute and per-return value varied over the study period. In a year when Illinois is decoupled from federal “bonus depreciation”, the value of the addition will increase, as the value of federal “bonus depreciation” has to be added back to the Illinois return. Conversely, in years when Illinois is coupled with federal “bonus depreciation”, FTI (the starting point for calculating Illinois CIT liability) will be lower than it otherwise would have been)

While special depreciation provisions are designed to provide for more rapid depreciation of assets at the front-end compared with traditional depreciation schedules, it is important to note that, on net, the total amount of depreciation during the life of the asset remains the same. The only difference is timing.

Finding 3: Decoupling from federal “bonus depreciation” impacts Corporate Income Tax receipts in the short-run. In the long-run the net effect of this provision on Corporate Income Tax liability is zero.

Nonbusiness Income or Loss Modification

Business income means all income, other than employee compensation, that can be apportioned by a formula among the states in which the organization does business. All income is business income, unless it is clearly attributable to only one state and is earned or received through activities totally unrelated to any business being conducted in any other state. Business income is the net of all deductions attributable to that income. Nonbusiness income is all income that is not business income. The Schedule NB is the main schedule used to calculate nonbusiness income. Once this amount is calculated, it is then transferred to Line 24 of the IL-1120. Nonbusiness income gets allocated, rather than apportioned, to Illinois.

Table 3-6: Descriptive Statistics of Nonbusiness Income

Tax Year	Number of Returns	Nonbusiness Income (\$)	Average Per Return (\$)
2007	747	\$8,889,377,521	\$11,900,104
2008	688	\$5,891,008,897	\$8,562,513
2009	627	\$4,738,850,616	\$7,557,975
2010	571	\$1,149,870,492	\$2,013,784
2011	438	\$2,001,012,615	\$4,568,522
5-Year Average	614	\$4,534,024,028	\$6,920,580

The number of returns and the amount of nonbusiness income varies significantly (Table 3-6). The average nonbusiness income per return before apportionment is modest, ranging from \$2.0 million in 2010 to \$11.9 million in 2007. Annually, nonbusiness income is claimed on 614 returns on average, less than 1 percent of all returns with no CIT liability.

Trust, Estate, and Non-Unitary Partnership Business Income or Loss

As is the case with nonbusiness income, income from trusts, estates and non-unitary partnerships is allocated to Illinois separately, and not apportioned. All business income or loss included in base income received from any non-unitary partnership, trust, or estate must be included in Line 25 of the IL-1120.

Table 3-7: Descriptive Statistics of Trust, Estate, and Non-Unitary Partnership Business Income

Tax Year	Number of Returns	Trust, Estate and Non-Unitary Partnership Business Income (\$)	Average Per Return (\$)
2007	193	\$3,306,456,654	\$17,131,900
2008	175	\$9,963,634	\$56,935

2009	159	\$320,700,834	\$2,016,986
2010	254	-\$5,288,660,706	-\$20,821,499
2011	219	\$1,997,499,703	\$9,121,003
5-Year Average	200	\$69,192,024	\$1,501,065

The number of returns fluctuates somewhat on an annual basis. However, business income from this source fluctuates wildly, ranging from -\$5,289 million in 2010 to \$9.9 million in 2008 and 3,306 million in 2007 (Table 3-7). The skewed nature of the 2010 data is explained by -\$7,220 million claimed on returns with a negative FTI. On average, income is claimed on 200 annually, just 0.26 percent of all returns with no CIT liability.

Summary

There is wide variation in the number of firms claiming specific IL-1120 line item modifications discussed in this section of the report, ranging from 12,650 for the Illinois Special Depreciation subtraction to 95 claiming a Related Party Expense addition. The most frequently claimed line items are the Illinois Special Depreciation subtraction, the federal NOLD addition, and the Illinois Special Depreciation addition.

Examining the annual average pre-apportionment, pre-tax business income amount for line items on the IL-1120 tax return, we find the rankings to be somewhat different compared with the ranking by average number of returns. In terms of value, the largest line items are the Foreign Dividend subtraction, the Federal NOLD addition, and the Illinois Special Depreciation addition and subtraction.

While the overall characteristics of firms having no CIT liability during the study period presented above are informative, the characteristics of the three sub-groups (positive FTI, zero FTI, and negative FTI) are significantly different. Therefore the next section of the report will examine each of these subcategories individually by tax year.

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Section 4

Analysis of Returns by Federal Taxable Income Status

Taxpayers with Positive Federal Taxable Income and No Corporate Income Tax Liability

Table 4-1 examines the number of IL-1120 returns with no Corporate Income Tax (CIT) liability and positive Federal Taxable Income (FTI) filed in Illinois over the last five years. Data indicate that while the series moves slightly with the business cycle, the percent of firms that have positive FTI and a negative business income prior to apportionment ranges between 15.3 to 17.8 percent for the period 2007 through 2010. Tax year 2011 is significantly different, at 32.0 percent. This is largely explained by the significantly lower number of firms having no tax liability and positive FTI in 2011 compared with the previous four years. Another difference in 2011 is the number of firms with positive FTI and positive business income prior to apportionment. The data suggests that suspending NOLDs resulted in approximately 2000 returns having a tax liability that otherwise would have used their NOLD to offset positive income.¹¹ Given data limitations, it is not possible to estimate the resulting CIT revenue associated with this policy change. It is important to note that any increase in revenue arising from the NOLD suspension will be at least partially offset when the current \$100,000 cap expires and firms have built up a significant inventory of NOLDs that they can use going forward. This will lead to downward pressure on future CIT revenue.

Table 4-1: Returns with Positive FTI and No CIT Liability

	2007	2008	2009	2010	2011	5- Year Average
Returns with Positive FTI	5,145	4,400	3,890	4,494	2,367	4,059
Returns with Positive FTI and Additions	5,145	4,400	3,890	1,178	2,365	3,396
Returns with Subtractions	2,655	2,312	2,060	2,508	1,382	2,183
Returns with Positive Business Income	4,223	3,753	3,296	3,806	1,609	3,337
Difference Between Positive FTI and Positive Business Income	922	647	594	688	758	722
Returns with Positive Business Income Divided by Returns with Positive FTI	82.1%	85.3%	84.7%	84.7%	68.0%	82.2%
Returns with a Business Loss Divided by Returns with Positive FTI	17.9%	14.7%	15.3%	15.3%	32.0%	17.8%

Finding 4: For the five-year average, of the 4,059 corporations with positive Federal Taxable Income that did not have an Illinois Corporate Income Tax liability, 722 (17.8 percent) showed a business loss after applying Illinois’ income modifications but prior to apportioning income to Illinois.

Table 4-2 contains income statistics associated with IL-1120 returns that have positive FTI and zero Illinois tax liability. With the exception of 2011, Positive FTI and Business Income appear to move with the business cycle.

On average, Illinois additions increase FTI by \$35.6 billion. The average value of Illinois subtractions are double that of additions, resulting in annual average positive business income of \$59.1 billion. Over the five-year period, positive business income is 53.5 percent of positive FTI. Income associated with subtractions in 2011 is significantly lower than the average: As noted earlier in the report, the major subtractions are the Foreign Dividend subtraction and the Illinois Special Depreciation subtraction.

Table 4-2: Income Statistics for Returns with Positive FTI and No CIT Liability

	2007 (\$b)	2008 (\$b)	2009 (\$b)	2010 (\$b)	2011 (\$b)	5 Year Average (\$b)
Positive Federal Taxable Income (FTI)	\$137.8	\$107.1	\$92.5	\$104.6	\$110.7	\$110.6
Positive FTI Plus Additions	\$158.0	\$129.0	\$127.5	\$136.4	\$130.3	\$136.2
Subtractions	\$75.5	\$74.1	\$82.3	\$78.3	\$48.9	\$71.8
Positive Business Income	\$72.7	\$47.7	\$40.9	\$55.6	\$78.6	\$59.1
Difference between FTI and Positive Business Income	\$65.1	\$59.4	\$51.6	\$49.0	\$32.1	\$51.4
Positive Business Income Divided by Positive FTI	52.8%	44.5%	44.2%	53.2%	71.0%	53.5%
Business Loss Divided by Positive FTI	47.2%	55.5%	55.8%	46.8%	29.0%	46.5%

Finding 5: For the 4,059 firms with positive Federal Taxable Income and no Corporate Income Tax liability, Illinois modifications reduced their Federal Taxable Income by an average of 46.5 percent, annually.

Taxpayers with Zero FTI and No CIT Liability

For the years 2007 through 2011, on average 19,927 returns had zero FTI and no Illinois tax liability (Table 4-3). For tax year 2011, the number of 10,737 is significantly different than previous years. On average, after additions, subtractions, nonbusiness income and income from trusts and partnerships, 50.7 percent of these returns have positive business income.

Table 4-3: Returns with Zero FTI and no CIT Liability

	2007	2008	2009	2010	2011	5-Year Average
Returns with Zero Federal Taxable Income (FTI)	23,987	22,358	20,959	21,593	10,737	19,927
Returns with Zero FTI and Additions	14,518	13,234	12,443	4,494	1,636	9,265
Returns with Subtractions	4,641	4,169	4,042	4,374	1,496	3,744
Returns with Positive Business Income	13,545	12,547	11,594	12,131	691	10,102
Difference between Returns with Zero FTI and Positive Business Income	10,442	9,811	9,365	9,462	10,046	9,825
Returns with Positive Business Income Divided by Returns with Zero FTI	56.5%	56.1%	55.3%	56.2%	6.4%	50.7%
Returns with a Business Loss Divided by Returns with Zero FTI	43.5%	43.9%	44.7%	43.8%	93.6%	49.3%

Table 4-4 illustrates that the value of additions and subtractions for returns with zero FTI and zero tax liability are relatively modest. Annual business income is \$11.8 billion, with the actual number for 2011 falling to \$0.8 billion.

Table 4-4: Income Statistics for Returns with Zero FTI and No CIT Liability

	2007 (\$b)	2008 (\$b)	2009 (\$b)	2010 (\$b)	2011 (\$b)	5-Year Average
Zero FTI	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Zero FTI Plus All Additions	\$20.2	\$16.3	\$14.7	\$29.1	\$3.3	\$16.7
Subtractions	\$4.1	\$3.8	\$3.3	\$8.8	\$2.2	\$4.4
Positive Business Income	\$15.4	\$12.3	\$10.9	\$19.7	\$0.8	\$11.8

Finding 6: For returns with zero Federal Taxable Income and no Corporate Income Tax liability, the net magnitude of Illinois income modifications resulted in 50.7 percent of these returns having positive business income, totaling \$11.8 billion.

Taxpayers with Negative FTI and No CIT Tax Liability

The vast majority of returns that do not have a tax liability are from firms that have negative FTI (see Table 2-2). The vast majority of these returns (98.9 percent) also have negative business income before apportionment (Table 4-5).

Table 4-5: Returns with Negative FTI and No CIT Liability

	2007	2008	2009	2010	2011	5 Year Average
Returns with negative FTI	49,950	52,146	53,141	50,901	51,517	51,531
Returns with Negative FTI Plus Additions	1,172	1,308	1,400	12,936	614	3,486
Returns with Subtractions	9,187	11,305	12,579	11,334	10,817	11,044
Returns with Positive Business Income	808	764	635	540	106	571
Difference between Returns with Negative FTI and Returns with Positive Business Income	49,142	51,382	52,506	50,361	51,411	50,960
Returns with Positive Business Income Divided by those with Negative FTI	1.6%	1.5%	1.2%	1.1%	0.2%	1.1%
Returns with a Business Loss divided by those with Negative FTI	98.4%	98.5%	98.8%	98.9%	99.8%	98.9%

The number of returns with negative FTI and no tax liability remains fairly consistent during the study period, suggesting that the NOLD suspension policy introduced in tax year 2011 did not impact the number of firms with negative FTI and zero tax liability.

Table 4-6: Income Statistics for Firms with Negative FTI and No CIT Liability

	2007 (\$b)	2008 (\$b)	2009 (\$b)	2010 (\$b)	2011 (\$b)	5 Year Average (\$b)
Negative FTI	-\$243.6	-\$463.1	-\$361.3	-\$201.4	-\$233.6	-\$300.6
Negative FTI Plus All Additions	-\$188.3	-\$396.0	-\$268.8	-\$137.9	-\$162.2	-\$230.6
Subtractions	\$34.5	\$40.5	\$58.6	\$49.8	\$72.0	\$51.1
Business Loss	-\$224.5	-\$435.0	-\$327.6	-\$180.6	-\$235.0	-\$280.5

When added to total negative FTI associated with firms with no tax liability, the net effect of additions and subtractions is to reduce business loss before apportionment by \$20.1 billion (Table 4-6).

Finding 7: The Illinois 2011 suspension of Net Operating Loss Deduction does not appear to have had a significant impact on the number of firms with negative Federal Taxable Income and no Corporate Income Tax liability.

Summary

We started with 75,517 returns with no Illinois CIT liability (Table 2-2). After accounting for additions, subtractions, non-business income, and partnership and trust business income, 61,507 returns did not have positive business income before apportionment, leaving 14,010 (18.6 percent) still to account for (Table 4-7).

Table 4-7: Returns with Positive Business Income and No CIT Liability

Returns with Positive Value for Business Income (Line 27)	Positive FTI	Zero FTI	Negative FTI	Total
2007	4,223	13,545	808	18,576
2008	3,753	12,547	764	17,064
2009	3,296	11,594	635	15,525
2010	3,806	12,131	540	16,477
2011	1,609	691	106	2,406
Average	3,337	10,102	571	14,010

Unfortunately our investigation going forward is somewhat limited as our FOIA request for information that would allow us to analyze factors leading from positive business income to base income allocable to Illinois and then to Illinois net income (Lines 28-46) was denied by IDOR.

Section 5

From Business Income or Loss to Net Income Allocated to Illinois

Due to data limitations, research in the characteristics of firms having positive business income prior to apportionment but no base income allocable to Illinois directly after they apportion business income to Illinois was not possible. Information on apportionment factors and line items on the IL-1120 after firms apportion base income to Illinois was denied, with the exception of income tax credits (Line 48).¹²

Had data been made available, the next step in our research would have been to do the following:

1. Examine the number of firms with positive business income but no base income allocated to Illinois after apportionment. Apportionment is the process by which income earned by multi-state firms gets allocated to Illinois. Simply put, in Illinois most multi-state firms allocate income based on the percent of total sales that the firm makes in Illinois. After apportionment, income allocated to Illinois is referred to as “base income or loss allocated to Illinois.”
2. Determine the impact of the discharge of indebtedness when added to base income allocated to Illinois after apportionment.
3. Quantify the magnitude of Illinois’ Net Operating Loss Deduction (NOLD). It is at this point on the tax return where the recent legislative suspension of Illinois NOLDs comes into play. Unfortunately, due to the Illinois Department of Revenue’s (IDOR’s) denial of a Freedom of Information Act (FOIA) request for this information, we are not able to quantify the impact of this recent tax policy change on the subset of firms being examined. While we cannot estimate its magnitude, it can be assumed that the NOLD suspension exerts upward pressure on net income allocated to Illinois. This combined with a higher tax rate leads us to hypothesize that firms with net income allocated to Illinois were more likely to claim and use tax credits in 2011 than in previous years.
4. Determine how many firms had positive business income before apportionment but zero net income allocated to Illinois.

As a result of not having this information, going forward, we have to make some assumptions when it comes to measuring the impact of tax credits on firms with positive business income and no Corporate Income Tax (CIT) liability.

Because we were unable to obtain critical information from IDOR, we use the following methodology to extrapolate how many firms fall into a no tax situation somewhere between apportionment and net income allocated to Illinois. First, we determine how many returns have

positive business income. Second, we calculate the number of returns that have credits on the IL-1120.

The final step in our approach is to subtract the number of firms with tax credits on the IL-1120 return from the number of firms with positive taxable income. This number is our best estimate of firms that do not have an Illinois tax liability due to how they apportion income to Illinois or because of the magnitude of their Illinois NOLD. Table 5-1 suggests that on average 13,878 firms fall into this category and reduce their business income to zero through a combination of their apportionment factor and their use of Illinois NOLs.

Table 5-1: Returns with Positive Business Income that Claim Tax Credits

	2007	2008	2009	2010	2011	5-Year Average
No Tax Liability						
Number of Returns with Positive Business Income	18,576	17,064	15,525	16,477	2,406	14,010
Number of Returns Using tax Credits	116	125	120	138	154	132
Difference	18,460	16,939	15,405	16,339	2,252	13,878
Positive FTI						
Number of Returns with Positive Business income	4,223	3,753	3,296	3,806	1,609	3,337
Number of Returns Using Tax Credits	112	110	107	118	111	112
Difference	4,111	3,643	3,189	3,688	1,498	3,226
Zero FTI						
Number of Returns with Positive Business Income	13,545	12,547	11,594	12,131	691	10,102
Number of Returns Using Tax Credits	4	4	6	14	38	13
Difference	13,541	12,543	11,588	12,117	653	10,088
Negative FTI						
Number of Returns with Positive Business income	808	764	635	540	106	571
Number of Returns Using Tax Credits	*	11	7	6	5	7
Difference	*	753	628	534	101	504

* Not disclosed by IDOR for reasons of confidentiality

Summary

Unfortunately, our research on Lines 28-39 was hampered because our request for data was denied by IDOR. As a result we have to extrapolate the impact of apportionment, the Illinois Net Operating Loss Deduction, and discharge of indebtedness in eliminating firms' CIT liability. Estimates suggest that 13,878 firms fall out during this section of the return.

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Section 6

Income Tax Credit Analysis

This section of the report will focus on income tax credits and, in particular, discuss the most common credits and address the question of how prevalent credits are in zeroing out Corporate Income Tax (CIT) liability.

Definitions

Claimed – The term employed to describe credit information contained on the Illinois Schedule 1299-D that may not have been used on the return.

Illinois Schedule 1299-D – An Illinois Department of Revenue (IDOR) tax schedule where firms calculate the value of credits they can claim as a result of their activities and performance in a given tax year.

Used – The term employed to describe credit information contained on the IL-1120 return.

Credits contained on the 1299-D schedule are:

- TECH-PREP Youth Vocational Programs Credit
- Dependent Care Assistance Program Credit
- Film Production Services Tax Credit
- Employee Child Care Tax Credit
- Jobs Tax Credit
- Enterprise Zone Investment Credit
- River Edge Redevelopment Zone Investment Credit
- High Impact Business Investment Credit
- Tax Credit for Affordable Housing Donations
- Economic Development for a Growing Economy (EDGE) Credit
- Research and Development Credit
- River Edge Redevelopment Zone Remediation Credit
- Ex-Felons Job Credit
- Veterans Jobs Credit
- Student-Assistance Contribution Credit
- Angel Investment Credit
- New Markets Credit
- River Edge Historic Preservation Credit
- Live Theater Production Tax Credit
- Hospital Credit (effective for Tax Year 2012)

Schedule 1299-D credits can be claimed in one year and used in a different tax year. All but the TECH-PREP and the dependent care credits have a five-year carry-forward period.¹³

IDOR captures only very basic information from Schedule 1299-D.¹⁴ All we can tell from the data captured and provided to us is how much of each credit a firm claims in any given year. It is important to note that not all credits claimed in a given year will actually be used in that same year. As noted earlier, firms can carry most credits forward for up to five years.

Table 6.1: Returns Using Credits by Federal Taxable Income Status

Tax Year	Positive FTI	Zero FTI	Negative FTI	Total
2007	112	4	*	116
2008	110	4	11	125
2009	107	6	7	120
2010	118	14	6	138
2011	111	38	5	154
Average	112	13	7	132

* Not disclosed by IDOR for reasons of confidentiality

We make the rational assumption that firms are using credits on their return in order to reduce or eliminate any remaining tax liability. Making this assumption suggests that:

Finding 8: Of the 75,517 returns with no Corporate Income Tax liability, only 132 (0.2 percent) fall into the no tax liability category through the use of tax credits. Tax credits are an extremely minimal factor in explaining why businesses have no CIT liability.

Given the very small number of firms that use tax credits on their return, Table 6-2 illustrates that these returns make up a very small fraction of all returns with no tax liability and positive business income.

Table 6.2: Returns Using Credits as a Percent of Returns with Positive Business Income

Tax Year	Positive FTI	Zero FTI	Negative FTI	Total
2007	2.7%	0.0%	*	0.6%
2008	2.9%	0.0%	1.4%	0.7%
2009	3.2%	0.1%	1.1%	0.8%
2010	3.1%	0.1%	0.9%	0.8%
2011	6.9%	5.5%	4.7%	6.4%
5-Year Average	3.3%	0.1%	1.2%	0.9%

* Not disclosed by IDOR for reasons of confidentiality

Finding 9: Use of tax credits does not explain why 99.1 percent of all returns with no Illinois Corporate Income Tax liability and positive business income prior to apportionment do not pay Corporate Income Tax.¹⁵

Note that in 2011 more firms claim credits than the average and these firms make up a significantly higher percent of firms with positive business income before apportionment, thereby giving some credence to our hypothesis that the 2011 Net Operating Loss Deduction (NOLD) suspension induced firms to change their historic behavior and use an above average amount of credits. We recommend more research be conducted to determine the relationship between suspending NOLs and tax credit use.

1299-D Credits - All Returns with No CIT Liability 2007-2011

The top three credits claimed on Schedule 1299-D associated with returns with no CIT liability are displayed in Table 6-3. They are the

- Enterprise Zone Investment Credit,
- EDGE Credit, and
- Research and Development Credit.

It should be noted that due to the limited amount of data captured by IDOR, the only hard numbers available on a credit-by-credit basis are for those claimed on the Schedule 1299-D. IDOR does not capture information on specific tax credits used on the IL-1120 return.

Table 6.3: Most Frequently Claimed Credits for Returns with No CIT Liability

Type of Incentive Claimed on Schedule 1299-D	2007	2008	2009	2010	2011
Enterprise Zone Investment (EZI) Credit					
Returns with EZI Credit	175	180	176	203	166
Value of EZI Credit Claimed	\$5,164,743	\$5,274,115	\$8,310,763	\$5,328,400	\$7,549,034
Average EZI Credit Claimed	\$29,513	\$29,301	\$47,220	\$26,248	\$45,476
EDGE Tax Credit					
Returns Earning EDGE Credit	33	41	35	54	56
Value of Edge Credit Claimed	\$24,235,479	\$22,709,754	\$27,206,410	\$32,410,590	\$48,274,456
Average Edge Credit Claimed	\$734,408	\$553,896	\$777,326	\$600,196	\$862,044
R&D Credit					
Returns Earning R&D Credit	129	146	136	172	166
Value of R&D Credit Claimed	\$32,983,755	\$39,255,040	\$13,275,469	\$21,244,222	\$36,734,267
Average R&D Credit Claimed	\$255,688	\$268,870	\$97,614	\$123,513	\$221,291

Note: More than one credit can be used on any given return.

The EZI credit is the most frequently claimed credit on the 1299-D schedule (900 returns over the study period), followed by the R&D credit (749 returns), and the EDGE credit (219 returns).

In terms of the value of credit claimed, over the five-year period the EDGE credit was the most significant (\$154.8 million), followed by the R&D credit (\$143.5 million), and then the EZI credit (\$31.6 million).

In terms of average credit claimed, the EDGE credit is significantly higher than the other 2 credits. The value of credits claimed has increased over the study period. The EDGE credit has grown over the 5-year period both in terms of the number of returns and value. However the R&D credit claimed appears to be countercyclical, while the EDGE credit and the EZI credits claimed do not seem to have fluctuated with the business cycle. For R&D this trend is intuitive. Firms will tend to cut back on R&D spending during an economic downturn. We would anticipate this being the case for the EDGE and EZI credits also. Further research should be conducted to explain trends in EDGE and EZI credits. One hypothesis to be explored for EDGE credits is that the current administration is becoming more aggressive in entering into EDGE agreements with companies.

Credits Claimed on Schedule 1299-D Versus Credits Used on Form IL-1120

Based on the limited data available, we develop a methodology to estimate the percent of credits used, compared with those claimed, to provide a context from which policy makers can discuss how useful credits are in achieving their stated goals.¹⁶ Firms undertake specific

behavior with the understanding that they will be able to claim credit if they meet the credit requirements.

As noted earlier, credits can be claimed on Schedule 1299-D in one tax year and used on Form IL-1120 in a different tax year. This carry-forward period is 5 years for the major credits. Table 6-4 illustrates that in any given year only a small fraction of the credits claimed are actually used. This ratio ranges from 21.0 percent in 2010 to 52.1 percent in 2007. In 2011, while the ratio of used-to-claimed is comparable with the five-year average compared with the previous 3 years the actual value of credits used is significantly higher for the group as a whole and for returns with positive Federal Taxable Income (FTI) in particular.

Table 6-4: Credits Used Versus Credits Claimed

	2007	2008	2009	2010	2011
All Returns with No Tax Liability					
Firms Using Credits on 1120	116	125	120	138	154
Number of Credits Claimed on 1299-D	337	372	352	440	400
Value of Credits Used on 1120	\$32,525,542	\$19,888,835	\$17,541,760	\$15,010,545	\$23,516,136
Value of Credits Claimed on 1299-D	\$62,383,977	\$71,481,742	\$55,913,612	\$71,461,430	\$92,591,028
Credits Used as a % of Credits Claimed	52.1%	27.8%	31.4%	21.0%	25.4%
Positive FTI					
Firms Using Credits on 1120	112	110	107	118	111
Number of Credits Claimed on 1299-D	155	149	113	176	132
Value of Credits Used on 1120	\$32,516,973	\$19,062,871	\$17,498,222	\$14,123,304	\$22,234,928
Value of Credits Claimed on 1299-D	\$53,407,242	\$50,697,642	\$36,111,967	\$40,282,051	\$57,565,302
Credits Used as a % of Credits Claimed	60.9%	37.6%	48.5%	35.1%	38.6%
Zero FTI					
Firms Using Credits on 1120	4	4	6	14	38
Number of Credits Claimed on 1299-D	42	48	42	83	51
Value of Credits Used on 1120	\$8,569	\$114,317	\$11,755	\$202,898	\$1,252,576
Value of Credits Claimed on 1299-D	\$208,598	\$862,192	\$401,881	\$4,608,703	\$5,992,319
Credits Used as a % of Credits Claimed	4.1%	13.3%	2.9%	4.4%	20.9%
Negative FTI					
Firms Using Credits on 1120	*	11	7	6	5
Number of Credits Claimed on 1299-D	140	175	197	181	217
Value of Credits Used on 1120	*	\$711,647	\$31,783	\$684,343	\$28,632
Value of Credits Claimed on 1299-D	\$8,768,137	\$19,921,908	\$19,399,764	\$26,570,676	\$29,033,407
Credits Used as a % of Credits Claimed	*	3.6%	0.2%	2.6%	0.1%

Finding 10: Between 2007 and 2011 the ratio of credits used on the IL-1120 to credits claimed on Schedule 1299-D ranges 21.0 percent to 52.1 percent.

The fact that firms who have claimed credits have not been able to use them has been the cause of much debate and resulted in the trend toward passing legislation to allow certain companies to use their EDGE credit against their Illinois withholding tax liability. This practice is somewhat controversial as it treats similarly-situated companies differently and on its face appears to violate basic tax policy principles of equity and transparency. Further research should be conducted to determine the impact of such practices and determine how to make policies consistent across similarly situated firms.

Summary

On average 132 returns (0.2 percent of returns without a CIT liability and 0.1 percent of all returns) use credits to bring about a no CIT liability situation. The average ratio of credits claimed on Schedule 1299-D to those used on the IL-1120 over the study period is 30.7 percent. The annual average value of credits used on the IL-1120 is \$169,432. The data suggest that credits play a very limited role in explaining why firms have no CIT liability.

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Section 7

Conclusions, Findings, and Recommendations

Conclusions

Based on the above research, most C- Corporations do not have an Illinois Corporate Income Tax (CIT) liability primarily because their Federal Taxable Income (FTI) is zero or negative. Illinois' corporate tax return starts with federally taxable income and that is the most important factor determining Illinois tax liability.

We find that Illinois income modifications to FTI play a limited role in explaining why firms do not have an Illinois CIT liability, particularly for returns with negative FTI. Eighty-two percent of returns with positive FTI have positive business income after accounting for Illinois modifications. This figure is 56.5 percent for returns with zero FTI and 1.6 percent of returns for those with negative FTI.

The data did not allow us to determine the specific impact of apportionment and the Illinois Net Operating Loss Deduction (NOLD) on income allocated to Illinois for tax purposes. However, the data is suggestive of the fact that of the 14,010 returns with positive business income prior to apportionment, 13,878 move into a no tax liability situation after apportionment and having accounted for the Illinois NOLD.

Finally, the role of Illinois tax credits on Illinois tax liability was examined and found to be minimal. The data suggest that on average 132 returns use credits to move into a no tax liability situation (0.2 percent of total returns with no CIT liability).

Findings

Finding 1: Ninety-five percent of the corporations with no Corporate Income Tax liability had either negative or zero Federal Taxable Income.

Finding 2: Federal Taxable Income is the driving factor behind Illinois Corporate Income Tax liability. For 2007 through 2011, on average 98.3 percent of corporations with negative Federal Taxable Income had no Illinois Corporate Income Tax liability while 88.5 percent with positive Federal Taxable Income had a Corporate Income Tax liability.

Finding 3: Decoupling from federal "bonus depreciation" impacts Corporate Income Tax receipts in the short-run. In the long-run the net effect of this provision on Corporate Income Tax liability is zero.

Finding 4: For the five-year average, of the 4,059 corporations with positive Federal Taxable Income that did not have an Illinois Corporate Income Tax liability, 722 (17.8 percent) showed a

business loss after applying Illinois' income modifications but before apportioning income to Illinois.

Finding 5: For the 4,059 firms with positive Federal Taxable Income and no Corporate Income Tax liability, Illinois modifications reduced their Federal Taxable Income by an average of 46.5 percent, annually.

Finding 6: For returns with zero Federal Taxable Income and no Corporate Income Tax liability, the net magnitude of Illinois income modifications resulted in 50.7 percent of these returns having positive business income, totaling \$11.8 billion.

Finding 7: Illinois' 2011 suspension of the Net Operating Loss Deduction does not appear to have had a significant impact on the number of firms with negative Federal Taxable Income and no Corporate Income Tax liability.

Finding 8: Of the 75,517 returns with no Corporate Income Tax liability, only 132 (0.2 percent) fall into the no tax liability category through the use of tax credits. Tax credits are an extremely minimal factor in explaining why businesses have no Corporate Income Tax liability.

Finding 9: Use of tax credits does not explain why 99.1 percent of all returns with no Illinois Corporate Income Tax liability and positive business income prior to apportionment do not pay Corporate Income Tax.

Finding 10: Between 2007 and 2011 the ratio of credits used on the IL-1120 to credits claimed on Schedule 1299-D ranges 21.0 percent to 52.1 percent.

Recommendations

Below are a list of some issues identified during the course of our research, as well as some questions we believe would be helpful to policymakers as they discuss and debate Corporate Income Tax policy in Illinois. This list is not intended to be exhaustive, but rather a starting point in developing a Corporate Income Tax research agenda. We believe that it is imperative that IDOR make more information available to tax policy researchers so that more data-driven research can be conducted by external groups.

1. Illinois Department of Revenue should identify reasons why their data is unreliable and address current policies and practices so that data that is currently unavailable, such as requested in our first and third Freedom of Information Act requests, can be made available.
2. Detailed data that would allow for an evaluation of the impact of the 2011 tax changes should be made available. Some questions to be answered are:
 - a. Why did the percent of filers with positive and zero Federal Taxable Income and no tax liability fall significantly in Illinois in 2011.
 - b. What, if any, relationship exists between suspending the Net Operating Loss Deduction, tax credit use, and Corporate Income Tax liability.

3. Provide data that would allow for the analysis of firms that apportion sales to Illinois and how they differ in characteristics from firms that allocate all of their sales to Illinois.
4. Allow examination of the deviation between book and taxable income and to analyze major factors contributing to this deviation. Such information is available on the U.S. Form 1120 and could be linked to the IL-1120 data. This would allow some understanding of why so many firms with nexus in Illinois have zero or negative federal income.
5. Allow for analysis by firm size and industry. Such information is available on the U.S. Form 1120 and could be linked to the IL-1120 data. There is some speculation that many of the firms that do not incur a tax liability are small. However, the Illinois Department of Revenue has not released information for this hypothesis to be confirmed.
6. Subject to confidentiality requirements, provide data that would allow for the calculation of average apportionment factors for firms with similar characteristics such as industry, size, multinationals, and Illinois-only based companies.
7. Provide data that would allow examinations of characteristics of all firms that claim and use tax credits and compare them with those that do not receive tax credits. Such data could be used to further investigate tax incentive policies, such as allowing certain firms to apply the EDGE credit to withholding, and allow for evaluation of the effectiveness of Illinois' tax credits.

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Appendix A

Definition of Form IL-1120, Corporation Income and Replacement Tax

Line 1 — This is the starting point – the Federal Taxable Income (FIT) from U.S. Form 1120.



Next Step – Illinois additions not included in the FTI on IL-1120, Line 1

Line 2 — **Net Operating Loss Deduction from U.S. Form 1120** – Prior to apportioning income to Illinois, net operating losses claimed on the U.S. 1120 must be added to FTI.

Line 3 — **State, Municipal, and Other Interest Income Excluded from FTI** – Tax-exempt interest as well as all tax-exempt interest distributions received from regulated investment companies is added back. A life insurance company must add back gross investment income earned from federally tax-exempt sources.

Line 4 — **Illinois Income and Replacement Tax Deducted in Arriving at FTI** – Income and replacement taxes deducted from the U.S. 1120 to arrive at FTI must be added back.

Line 5 — **Illinois Special Depreciation Addition** – The Illinois Special Depreciation Addition reverses the effects of the 30 percent or 50 percent “bonus depreciation” allowed by IRC Section 168(k) for depreciable property placed in service after September 10, 2001, and before January 1, 2005 (or, in the case of certain property acquired under a contract that was binding as of January 1, 2005, and before January 1, 2006), during 2008 through 2010 under the federal Economic Stimulus Act of 2008, and the American Recovery and Reinvestment Act of 2009. The 100 percent bonus depreciation allowed under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, is allowed by Illinois, and does not need to be added back.

Line 6 — **Related-Party Expenses Additions** – The interest or intangible expenses, or insurance premiums paid to an affiliated company, to the extent these expenses exceed any taxable dividends received from the affiliated company. An affiliated company means any person who would be a member of a unitary business group, but cannot be included in the group because 80 percent or more of its business activities are conducted outside the United States or because of the rule against combining insurance companies, financial organizations, or transportation companies with companies engaged in other businesses. Intangible expenses mean royalties and fees paid for intangible assets, losses incurred on sales or other disposition of intangible assets to an affiliated company, losses on factoring or discounting transactions with an affiliated

company, and deductible expenses incurred in connection with the acquisition, use, management, or sale or other disposition of an intangible asset. Intangible assets include patents, patent applications, trade names, trademarks, service marks, copyrights, mask works, trade secrets, and similar types of intangible assets.

Line 7 — Distributive Share of Additions – A partner in a partnership, a shareholder in an S corporation, or a beneficiary of a trust or an estate, must include the distributive share of additions received from the partnership, S corporation, trust, or estate. Multiple schedules must be included for recipients from multiple entities.

Line 8 — Other Additions (from Schedule M, Other Additions or Subtractions for Businesses): Examples of items on schedule M that must be added back include:

- Notes, bonds, debentures, or obligations issued by the Governments of Guam, American Samoa, Puerto Rico, the Northern Mariana Islands, or the Virgin Islands.
- Lloyd's plan of operations loss if included in FTI.
- If income reported for an asset in the current tax year was reported as business income and in the past has been reported as nonbusiness income, all deductions claimed for expenses connected with the income in the current and previous two tax years must be added back.

Line 9 — The sum of Lines 1 through 8 equal the businesses total income or loss.



Next Step – Illinois subtractions allowed to deduct from the total Illinois income or loss on IL-1120, Line 9

Line 10 — Interest Income from U.S. Treasury and other exempt federal obligations – Interest received or accrued from U.S. Treasury bonds, notes, bills, federal agency obligations, and savings bonds included in FTI.

Line 11 — Enterprise Zone or River Edge Redevelopment Zone Dividend Subtraction – Dividends received from a corporation that conducts substantially all of its business operations in an Illinois Enterprise Zone or Rivers Edge Redevelopment Zone.

Line 12 — Enterprise Zone or River Edge Redevelopment Zone Interest Subtraction – A financial organization may subtract any interest income received before August 7, 2012, during the tax year from a loan made to a borrower, to the extent the loan is secured by qualified property that is eligible for the Enterprise Zone Investment Credit or River Edge Redevelopment Zone.

Line 13 — High Impact Business Dividend Subtraction – A subtraction for dividends received from a corporation that is designated by the Department of Commerce and Economic Opportunity (DCEO) as a “High Impact Business” and conducts

business operations in a federally designated Foreign Trade Zone (or sub-zone) located in Illinois.


- Line 14 — High Impact Business Interest Subtraction** – A financial organization may subtract any interest income received during the tax year from a loan made to a borrower, to the extent the loan is secured by qualified property that is eligible for high impact business investment credits.
- Line 15 — Contribution Subtraction** – Deductions of twice the amount of any contribution made during the tax year to a designated zone organization to be used for an Enterprise Zone or River Edge Redevelopment Zone project approved by DCEO are allowed, provided that the contribution qualifies as a charitable contribution under Internal Revenue Code (IRC) Section 170(c).
- Line 16 — Contribution to Certain Job Training Projects** – Any contribution made to a job training project established under the “Tax Increment Allocation Redevelopment Act”.
- Line 17 — Foreign Dividend Subtraction** – The foreign dividend gross-up amount included in taxable income and contained on Illinois Schedule J, Foreign Dividends, is subtracted if electing a foreign tax credit under the provisions of the IRC Section 901.
- Line 18 — Illinois Special Depreciation Subtraction** – The Illinois Special Depreciation Subtraction and Addition reverses the effects of the 30 percent or 50 percent “bonus depreciation” allowed by IRC Section 168(k) for depreciable property placed in service after September 10, 2001, and before January 1, 2005 (or, in the case of certain property acquired under a contract that was binding as of January 1, 2005, and before January 1, 2006), during 2008 through 2010 under the federal Economic Stimulus Act of 2008, and the American Recovery and Reinvestment Act of 2009. The 100 percent bonus depreciation allowed under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, is allowed by Illinois, and no adjustments are required.
- Line 19 — Related-party expenses subtraction** – These expenses are allowed if
- A company added back interest paid to an affiliated company. Any interest received from that company during the tax year may be subtracted, up to the amount of any addition for interest expense paid to that company. Also, if intangible expenses from a transaction with an affiliated company are added back, any income received during the tax year from similar transactions with the affiliated company may be subtracted, up to the amount of the addition for intangible expense for that company
 - A company is an affiliated company, and receives interest or intangible income from someone who had to add back the interest and intangible expense, or insurance premiums on their Illinois Schedule 80/20. Interest or intangible income from that person can be subtracted.
- Line 20 — Distributive share of subtractions** – The distributive share of subtractions passed through by a partnership, S corporation, trust, or estate can be subtracted. This does not include any amounts passed through that are reflected

on Illinois Schedule 1299-B, Enterprise Zone or Foreign Trade Zone (sub-zone) Subtractions (for corporations and fiduciaries).

- Line 21 — Other Subtractions (from Schedule M)** – Subtractions allowed on Illinois Schedule M include:
- Any “exempt-interest” dividends, as defined in IRC Section 852(b)(5), paid to shareholders for the tax year by a regulated investment company.
 - Notes, bonds, debentures, or obligations issued by the Governments of Guam, American Samoa, Puerto Rico, the Northern Mariana Islands, or the Virgin Islands, to the extent that they were required to add these amounts to your FTI.
 - Lloyd’s plan of operations income if reported on Form IL-1023-C and included in FTI.
 - The amounts disallowed as federal deductions or interest expenses under IRC Sections 171(a)(2), 265, 280C, 291(a)(3) and 832(b)(5)(B)(i).
 - The amount equal to the deduction used to compute the federal tax credit for restoration of amounts held under claim of right under IRC Section 1341.
- Line 22 — Total Subtractions** – Total value of all subtractions.
- Line 23 — Base income or loss** after Illinois subtractions.



Next Step – If income is derived from both inside and outside of Illinois, a calculation must be completed to determine what portion of income or loss is allocable to Illinois.

- Line 24 — Nonbusiness income or loss**
- Line 25 — Trust, estate, and non-unitary partnership business income or loss**
- Line 26 — Sum of Line 24 and Line 25**
-  **Line 27 — Business income or loss** – after subtracting nonbusiness, trust, estate, and partnership income (subtract Line 26 from Line 23)
- Line 28 — Total sales everywhere**
- Line 29 — Total sales inside Illinois**
- Line 30 — Apportionment Factor** – Divide Line 29 by Line 28
- Line 31 — Business income or loss apportionable to Illinois** – multiply Line 27 by Line 30.
- Line 32 — Non business income or loss allocable to Illinois**
- Line 33 — Trust, estate, and non-unitary partnership business income or loss apportionable to Illinois.**
- Line 34 — Base income or loss allocable to Illinois**



Next Step – Figuring Illinois net income

- Line 35 — Base income or net loss** – either Line 23 or Line 34
- Line 36 — Discharge of Indebtedness Adjustment**
- Line 37 — Adjusted base income or net loss** – Add Line 35 and Line 36.
- Line 38 — Illinois Net Operating Loss Deduction** – (suspended in tax year 2011)
- Line 39 — Net Income** – Subtract Line 38 from Line 37.



Next Step – Figuring Illinois tax after credits

- Line 45 — Income tax** – Multiply Line 39 by tax rate – 7 percent for 2011, 4.8 percent in previous years
- Line 46 — Recapture of investment credits**
- Line 47 — Income taxes before credits** (add line 45 and line 46)
- Line 48 — Income tax credits**
- Line 49 — Income tax after credits**

Legal Citations for Illinois Modifications and Credits

TECH-PREP Youth Vocational Program Credit	35 ILCS 5/209
River Edge Redevelopment Zone Site Remediation Tax Credit	35 ILCS 5/201(n)
Job Training Contribution Subtraction	35 ILCS 5/203 (b) (P)
Enterprise Zone; Foreign Trade Zone - Jobs Credit	35 ILCS 5/201(g)
Dependent Care Assistance Credit	35 ILCS 5/210
High Economic Impact Business Dividend Subtraction	35 ILCS 5/203 (b) (L)
Research and Development Credit	35 ILCS 5/201 (k)
Interest Expense Subtraction	35 ILCS 5/203 (b) (I)
Illinois Net Operating Loss Deduction	35 ILCS 5/207 (a) & (b)
High Economic Impact Business Investment Credit	35 ILCS 5/201 (h)
Foreign Insurer Rate Reduction	35 ILCS 5/201(d-1)
Employee Child Care Tax Credit	35 ILCS 5/210.5
Film Production Services Credit	35 ILCS 5/213
River Edge Redevelopment Zone - Jobs Tax Credit	35 ILCS 5/201 (g)

Enterprise Zone Investment Credit	35 ILCS 5/201 (f)
Enterprise Zone Charitable Contribution Subtraction	35 ILCS 5/203 (b) (2) (N)
High Economic Impact Business Interest Subtraction	35 ILCS 5/203(b)(M-1)
Ex-Felons Jobs Credit	35 ILCS 5/216
River Edge Redevelopment Zone Investment Credit	35 ILCS 5/201 (f)
Attorney-In-Fact Subtraction	35 ILCS 5/203(b) (R)
Affordable Housing Donations	35 ILCS 5/214
Enterprise Zone Dividends Subtraction	35 ILCS 5/203 (b) (2) (K)
Veterans Jobs Credit	35 ILCS 5/217
Bonus Depreciation	35 ILCS 5/203(b)(T)
Capital Gain or Loss	35 ILCS 5/203(b)(U)
Enterprise Zone Interest Subtraction	35 ILCS 5/203 (b) (2) (M)
River Edge Redevelopment Zone Charitable Contribution Subtr.	35 ILCS 5/203 (b) (2) (N)
River Edge Redevelopment Zone Interest Subtraction	35 ILCS 5/203 (b) (2) (M)
River Edge Redevelopment Zone Dividends Subtraction	35 ILCS 5/203 (b) (2) (K)
Credit for Student Assistance Contributions	35 ILCS 5/218
Economic Development for a Growing Economy Tax Credit	35 ILCS 5/211

Appendix B

FOIA Denial



Illinois Department of Revenue

101 W. Jefferson St.
Springfield, IL 62702

RESPONSE TO REQUEST FOR PUBLIC RECORDS

TO: Ms. Connie Beard Executive Director Illinois Chamber Tax Institute 215 E. Adams Street Springfield, IL 62701	Ms. Carol Portman President Taxpayer's Federation of Illinois 430 E. Vine Street, Suite A Springfield, IL 62703
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DESCRIPTION OF REQUESTED RECORD(S)

"See Attached Summary. We are requesting aggregate line item data for certain lines from Forms 1120 and 1299-D for the years 2011, 2009 and 2007 for C Corporations - those with positive or zero Federal Taxable Income that did not pay tax in any of the requested years." (See Attachment A)

Your request for the above-captioned records is denied.

Dear Ms. Beard and Ms. Portman:

This letter is a follow-up to our meeting on December 4, and a formal, written denial of your FOIA request as we expressed to you at that meeting.

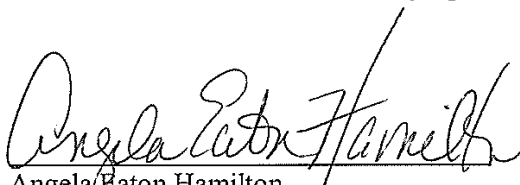
The data you are seeking in this request is aggregated business income tax data which does not exist. As previously explained in two separate meetings, the Department's computer system is a tax processing system designed to process tax filings and payments on an individual basis. It does well what it is designed to do. It is not designed, however, to cleanly aggregate data line by line as you seek. Further, because of the complicated nature of Illinois tax laws, the way the data are collected, and the distinct ways various businesses are treated, the results of such an aggregation would be confusing at best, without a line by line examination of each and every confidential tax return. For this reason, we are denying your request as unduly burdensome under the Freedom of Information Act (5ILCS140) Section 3 (g).

The Freedom of Information Act provides that requestors be given an opportunity to narrow a request deemed unduly burdensome. The Department of Revenue previously provided such an opportunity following your original request and provided five years worth of detailed data to you. That data included aggregated data for tax years 2007, 2008, 2009, 2010 and 2011 from Form IL 1120 Lines 1-30 for businesses with positive,

zero and negative FTI, and income tax credits from schedule 1299D. Your current request, dated November 21, 2013, which seeks aggregated data for the lines below Line 30 on Tax Forms 1120 and 1299-D, is duplicative of your original request, dated September 17, 2013, because while it is for fewer tax years, it essentially seeks the same type of data originally denied and referenced above.

The challenges of providing the data you seek were addressed in detail in a meeting with Carol Portman and Mike Klemens of the Taxpayers Federation of Illinois on October 10, 2013. Those same challenges were addressed again in detail in a conference call on December 4, 2012 between the Department and Ms. Portman, Mr. Klemens, and Connie Beard of the Illinois State Chamber of Commerce.

The Department would like to make it clear that it is not a lack of desire on our part to provide the data to you. The Department believes it is important to operate in an open and transparent manner. Rather, the denial is a reflection of Illinois' complex tax system and the limitations describe above in trying to use a tax processing system as a research tool.



Angela Eaton Hamilton
Acting Freedom of Information Officer
Illinois Department of Revenue
101 W Jefferson St
Springfield, IL 62702
217 785-5383

12/23/13
Date

Appendix C

About JD Michael and the Author

JD Michael LLC, a tax consulting firm, was founded in 2003 by five professionals who previously worked as senior managers for the Illinois Department of Revenue.

DR. NATALIE A. DAVILA

PROFESSIONAL PROFILE

For 15 years Dr. Davila participated on a daily basis in the formulation and execution of data-driven tax and economic development policies at the local and state level. She has extensive experience in developing methodologies, gathering relevant data, analyzing and making recommendations on state tax issues including but not limited to individual income, corporate income, sales, cigarette and tobacco products, liquor, gaming, and lottery taxes. Natalie also has significant experience in the design, administration, and analysis of survey, case study, and focus group research. Dr. Davila was the Research Director for the Illinois Department of Revenue from 2003 to 2013.

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Endnotes

¹ <http://progressillinois.com/news/content/2013/10/23/citizens-storm-speaker-madigans-office-seek-meeting-illinois-corporate-tax-d>. http://articles.chicagotribune.com/2012-08-06/opinion/ct-oped-0806-mccarron-20120806_1_tax-collectors-citizens-for-tax-justice-corporations. <http://www.forbes.com/sites/timworstall/2011/08/16/two-thirds-of-us-corporations-dont-pay-federal-income-tax-true-but-horribly-misleading/>. Articles accessed 11/3/2013

² By David Borris, David Hatch and Rev. Marilyn Pagan-Banks September 26, 2013 5:42PM. As reported in the Chicago Sun Times. <http://www.suntimes.com/news/otherviews/22811709-452/why-do-a-third-of-corporations-fail-to-pay-state-taxes.html>. Accessed December 9, 2013.

³ Ibid

⁴ The department does not data capture all lines on the return or associated schedules.

⁵ For a discussion of apportionment, see Tax Facts, Summer 2013.

⁶ ICC and TIF corresponded by e-mail with IDOR's FIOA office on November 3, 2012 seeking some clarification on the information that had been received. We found some "outliners" in the data and wanted to confirm the data were accurate. We received an e-mail on November 4, 2013 confirming that the information we had received was accurate.

⁷ For more information, see Tax Facts, Summer 2013.

⁸ Apportionment is a term used to describe how multi-state firms allocate income to states for purposes of state taxation.

⁹ The vast majority of states allow a foreign dividend subtraction (41 states plus DC). Four states do not have a subtraction because they do not tax general business income. The remaining 5 states do not have a foreign dividend subtraction. For more information, see 2014 State Tax Handbook, CCH Editorial Staff Publication, Wolters Kluwer, CCH.

¹⁰ Michael S. Schadewald, State Taxation of U.S.-Controlled Foreign Corporations: How Big Is the Tax Bite?, International Tax Journal, September–October 2010. Accessed 17 January 17, 2014.

¹¹ The four-year average number of firms= 4,482. Subtracting the number in 2011 from this number=2,115.

¹² A third FOIA request made to IDOR was submitted on November, but was rejected. The denial was received formally on December 23, 2013.

¹³ The TECH-PREP and Dependent Care Assistance Program Credit have a 2-year carry-forward period.

¹⁴ Information captured by IDOR is notated with an arrow to the right of the line-item number on the schedule.

¹⁵ 5-year annual average=(132/75,517)

¹⁶ A more sophisticated approach would be to conduct this analysis on a credit-by-credit basis and have information on credits claimed in previous years but not used in the denominator. This analysis is not possible because IDOR does not capture or calculate this information.