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Navigating Illinois' State/Local Tax Maze

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People don't like to pay taxes and do not much care which government imposes the tax. In Illinois a taxpayer probably cannot tell whether a particular tax is a state or local tax, because Illinois state government collects many local taxes. Adding to the confusion, Illinois has more local governments than any other state in the nation and many of them are authorized to impose those taxes.

In addition to allowing local governments to impose numerous taxes, Illinois shares a significant amount of its own tax revenues directly with units of local government pursuant to statutory mandate. Today, nearly one in four dollars the Illinois Department of Revenue (IDOR) collects is either a local tax that it administers or a state tax that is statutorily allocated to particular local governments. That figure excludes tax revenues that the state collects and passes along to local governments like school districts or municipalities

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NOTES FROM THE INSIDE. . .

By Carol S. Portman

This issue of *Tax Facts* examines the complex interrelationships between taxes imposed by state government and those imposed by various units of local government. We have also dusted off, and updated the numbers for, a piece that former Taxpayers' Federation President Jim Nowlan wrote five years ago, outlining how to read state comparisons and rankings. I suspect we all hear frequent declarations that Illinois is worst (or best) in a particular tax burden category, and Jim offers sage advice to keep in mind when digesting the rankings.

Jim's piece points out the dilemma of using rankings based on U.S. Census Bureau data, because of the delays in compiling the information. The most current information available from this otherwise outstanding resource is 2012, the first full year of Illinois' temporary income tax rate increases, released just as the rate increases to begin to roll back.

On the question of state versus local taxation, The Taxpayers' Federation is not suggesting that there is inherently a problem with either state administration of local taxes or state revenue sharing with local governments. Both offer significant advantages to taxpayers and governments. However, at TFI we champion transparency, and the system that has evolved makes it hard to tell whose tax one is paying. One of the factors that this exercise highlights is the large number of local governments in Illinois; we lead the nation in that particular statistic.

through budgetary programs, things like school aid or municipal public health department grants.

The tax system that has evolved in Illinois has efficiency advantages for both government and those paying the tax. When a store owner reports both state and local sales taxes on the same form, the retailer has less paperwork, and the local government does not have to employ (at a cost to its taxpayers) the personnel to process the returns, deposit the receipts and enforce collection of the tax.

Illinois' tax system also has disadvantages. For example, the large amount of locally imposed sales tax means that local governments consume much of the tax capacity, limiting state government's ability to raise more money by simply increasing state sales tax rates. Today, the state receives funds pursuant to a state tax rate of 5 percent, while the combined state and local tax rate in some Illinois communities runs as high as 10 percent.

This article catalogs the extent to which various taxes paid by Illinois residents are collected by state government on behalf of or directly shared with units of local government to get a state/local breakdown of collections. We are using 2012 data – the latest data for which IDOR has published its *Annual Report of Collections and Distributions* (the Annual Report).

According to the Annual Report, in Fiscal Year 2012 IDOR collected $38.2 billion, of which $3.1 billion was from locally imposed taxes administered by IDOR and another $5.1 billion was state tax revenue statutorily shared with and spent by local governments. The Annual

Report does not include another $563 million in Motor Fuel Taxes collected by the Department of Revenue and distributed by the Department of Transportation to municipalities, counties and road districts. After excluding the $2 billion set aside to pay income tax refunds in FY2012, local governments' direct share of total state tax collections is 24 percent.

None of the additional income tax revenue generated by the 2011 temporary income tax increases was shared with local governments. In 2010, before the income tax rate increases, the direct local share of taxes collected by IDOR was 31 percent. As state tax collections decline with the income tax rate rollback in 2015, local governments' share of total tax collections will rise.

The following listing summarizes various distributions to local governments, both through statutory sharing of state tax receipts and through state administration of locally imposed taxes. For each we give the amount distributed in FY 2012 and the percentage that represents of total state and local tax collections (less Income Tax Refund Fund deposits). Some minor distributions are ignored.

INCOME TAX

The Illinois Income Tax is state imposed. (Cities and counties may not impose their own income taxes.) Illinois state government has shared a portion of its income tax receipts with municipalities and counties since the income tax was enacted in 1969. Originally municipalities and counties received 8.33 percent (one-twelfth) of collections, distributed based on populations with the county population being the number of persons in the unincorporated area of the county. Local governments and schools shared all the revenue from the 1989 income tax surcharge. When the surcharge was made permanent, the county and municipal share of the total income tax collected was set first at 9.1 then finally, in 1995, at 10 percent. The temporary rate increase of 2011 was designed to direct all new money to the state, so the local share of income taxes collected was reduced to 6 percent for Individual Income Tax and 6.86 percent for Corporate Income Tax. (As the income tax rate rolls back, beginning in 2015, the local share increases accordingly.)
Interestingly, the population-based distribution – based on census data – results in Illinois municipalities asking the U.S. Census Bureau to conduct special censuses more often than in any other state. The reason: In FY 2014, the average annual income tax distribution was $95 per capita. If a special census identified 1,000 new residents in a fast-growing municipality, that municipality will receive $95,000 a year in increased revenues until the next census.

Income Tax Revenue Sharing
$1,095,259,945 3.0 percent

PERSONAL PROPERTY REPLACEMENT TAX

The Personal Property Replacement Taxes are state imposed but entirely distributed to local governments. The Illinois Constitution of 1970 mandated the elimination of the personal property tax on businesses (primarily a tax on machinery and equipment) by 1979 and the replacement of the revenue lost by local governments. That replacement ended up being a 2.5 percent surcharge on the Illinois Corporate Income Tax and a 1.5 percent tax on the entity-level income of partnerships, Subchapter S corporations, and trusts along with a 0.8 percent tax on the invested capital of public utilities. When deregulation changed the taxation of utilities, the Electricity Distribution Tax and the Telecommunications Infrastructure Maintenance Fee were imposed in 1998 to maintain revenue flow to local governments.

Personal Property Replacement Tax Distributions $1,235,977,355 3.4 percent

SALES AND USE TAXES

Sales and Use Taxes fall both into the revenue sharing (imposed by state and statutorily allocated in part to locals) and the administered for (imposed locally and administered by state) categories. The statutory state sales tax rate is given as 6.25 percent. The 6.25 percent breaks down to a 5 percent state tax, a 1 percent municipal or county tax, and a 0.25 percent county tax. Until the 1990 sales tax reform effort, the 1.25% in local taxes were locally imposed; after sales tax reform they continued to be administered by the state as if they were locally imposed, with the tax receipts being distributed back to the municipality or county where the sale took place.

<u>Municipal and County Retailers Occupation Tax (1 Percent Share)</u>

State law imposes these taxes, the broadest based of all sales and use taxes in Illinois, that include groceries, drugs, and medical appliances that are exempt from most other sales and use taxes in Illinois. If the sale occurs within a municipality the local 1 percent is distributed to that municipality. If it the sale takes place in an unincorporated area, the tax is distributed to the county.

Municipal and County ROT
$1,623,725,907 4.5 percent

<u>Countywide 0.25 Percent Tax (formerly County Supplemental Tax)</u>

State law imposes this tax on all general merchandise sales (excluding food, drugs, and medical appliances). Revenues are allocated to the county where the sale occurred (whether or not within a municipality). In Cook County, this money is distributed to the RTA instead of to Cook County Government. (See the discussion below regarding transit district taxation.)

Countywide 0.25 percent tax
$212,977,744 0.6 percent

<u>Home Rule and Non-Home Rule Sales Taxes</u>

IDOR administers the sales tax that home-rule governments can impose in 0.25 percent increments, as well as the sales tax that non-home rule municipalities can, subject to referendum, impose in 0.25 percent increments up to a maximum of 1 percent. (There is no 1 percent maximum for home rule municipalities). The state also administers Chicago's Home Rule

Vehicle Use Tax for vehicles purchased in Cook, DuPage, Kane, Lake, McHenry and Will counties and registered to an address in Chicago.

Home Rule and Non-Home Rule Sales Taxes

$1,433,074,606 4.0 percent

Chicago Soft Drink Tax

IDOR administers the 3 percent tax on the sale of soft drinks imposed by Chicago.

Chicago Soft Drink Tax

$9,449,784 <0.1 percent

County Motor Fuel Tax

IDOR administers a 4-cent per gallon tax on motor fuel imposed by DuPage, Kane, and McHenry counties.

County Motor Fuel Tax

$32,027,253 0.1 percent

DuPage Water Commission Tax

IDOR administers a 0.25 percent sales tax imposed by the DuPage Water Commission within its boundaries.

DuPage Water Commission Tax

$31,835,073 0.1 percent

Metro-East Park and Recreation District Tax

IDOR administers a 0.10 percent sales tax imposed by the park district within its boundaries.

Metro-East Park and Recreation Tax

$4,421,940 <0.1 percent

Municipal Business District Taxes

IDOR administerssales taxes imposed by municipalities within business districts inside their boundaries. There were 64 business districts in FY 2012.

Municipal Business District Tax

$10,076,400 <0.1 percent

MPEA Food and Beverage Tax

IDOR administers the 1 percent sales tax on restaurant meals and drinks imposed by the Metropolitan Pier and Exposition Authority within a specific district in downtown Chicago.

MPEA Food and Beverage Tax

$36,864,404 0.1 percent

County Public Safety Tax

IDOR administers the sales tax that counties impose, with voter approval, in 0.25 percent increments for public safety, transportation, or public facility purposes.

County Public Safety Tax

$86,612,059 0.2 percent

County School Facility Tax

IDOR administers the sales tax that counties impose, with voter approval, in 0.25 percent increments for school facilities.

County School Facility Tax

$39,328,131 0.1 percent

Flood Prevention Tax

IDOR administers the 0.25 percent sales tax imposed by flood prevention districts in Madison, Monroe, and St. Clair counties to repair and rebuild levees.

Flood Prevention Tax

$11,340,707 <0.1 percent

USE TAX ON OUT-OF-STATE SALES

Sales Tax reform in 1990 increased the Use Tax on out-of-state sales from 5 percent to 6.25 percent. The state collects and distributes the 1.25 percent Use Tax on general merchandise and the 1 percent tax on groceries, drugs, and medical appliances primarily to local governments based on a statutory formula that gives 20 percent to Chicago, 10 percent to the RTA, 0.6 percent to the Metro-East Mass Transit District (transit district taxes are addressed below), $37.8 million to Build Illinois, and the balance to counties and municipalities based on population.

Chicago $53,522,095 0.1 percent

Downstate $147,921,668 0.4 percent

SIMPLIFIED MUNICIPAL TELECOMMUNICATION TAX

IDOR administers (outside of Chicago which administers its own tax) taxes imposed by municipalities on the origin or receipt of telecommunications within their boundaries. Such a tax can be imposed in 0.25 percent increments up to 6.0 percent.

Municipal Telecommunications Tax

$301,176,919 0.8 percent

HOTEL TAXES

IDOR administers three hotel taxes imposed in Chicago: a 1 percent city tax, a 2 percent Illinois Sports Facility Authority Tax, and a 2.5 percent Metropolitan Pier and Exposition Authority Tax.

Hotel Taxes

$96,411,535 0.3 percent

AUTOMOBILE RENTING TAXES

IDOR administers automobile renting taxes imposed by municipalities, counties, and the Metropolitan Pier and Exposition Authority.

Automobile Renting Taxes

$34,832,648 0.1 percent

MOTOR FUEL TAX

DOR collects the state-wide motor fuel tax and deposits the proceeds into funds under control of the Department of Transportation. After diversions to funds earmarked for boating and railroad crossing, and the retention of amounts intended to cover costs of the Revenue and Transportation departments, the remaining money is split 45.6 percent for state purposes and 54.4 percent for locals, including municipalities, counties, and road districts.

Motor Fuel Tax

$563,317,620 1.6 percent

TRANSIT DISTRICTS

Transit districts in Illinois – the Regional Transportation Authority (RTA), the Metro East Mass Transit District, and a number of downstate transportation districts, receive funding through an assortment of taxes they impose and state tax revenues shared with them. The RTA is the most complex.

<u>RTA</u>

In Cook County the IDOR collects an RTA-imposed sales tax of 1 percent on general merchandise and 1.25 percent on food and drugs. In the five collar counties (DuPage, Kane, Lake, McHenry and Will) IDOR collects an RTA-imposed tax 0f 0.75 percent on both general merchandise and food and drugs. However, one-third of what the state collects in the collar counties (0.25 of 0.75 percent) is allocated to the county governments for transportation and infrastructure demands.

IDOR also collects and remits to the RTA Cook County's allocation of the 0.25 percent sales and use tax on general merchandise. As discussed above, in all other counties this 0.25 percent tax replaced the county supplementary tax.

The RTA receives 10 percent of the 1.25 percent Use Tax IDOR collects on out of state sales.

The RTA also receives a 30 percent match from the state's general funds (which is reported as a transfer to the Public Transportation Fund) for all the above receipts, (other than the diversion to the collar counties) and for a Real Estate Transfer Tax surcharge that Chicago imposes and collects on real estate sales and shares with the RTA.

RTA Sales Tax	
$846,625,622	**2.3 percent**

Collar Counties' Share of RTA Tax	
$111,849,726	**0.3 percent**

RTA Share of Statewide Use Tax	
$26,761,047	**0.1 percent**

RTA Share of .25 Percent Tax in Cook	
$119,473,705	**0.3 percent**

RTA 30 Percent Match	
$312,689,437	**0.9 percent**

<u>Metro East Mass Transit District (MED)</u>

IDOR collects a 0.25 percent sales tax imposed by the Metro East Mass Transit District within portions of Madison County and a 0.75 percent sales tax imposed by the Metro East Mass Transit District on general merchandise and a 0.25 percent sales tax on food, drugs, and titled vehicles in portions of St. Clair County. In St. Clair County the state also administers a MED-imposed $20 per transaction fee on the sale of vehicles.

MED Sales Tax	
$29,007,615	**0.1 percent**

<u>Downstate Public Transportation Districts</u>

Additionally, the MED and other transit districts outside of the RTA receive, via a transfer from the Downstate Public Transportation Fund, 3/32nds of the state's 5 percent sales and use tax collected within the districts. And the Downstate Public Transportation Fund also receives 0.6 percent of the receipts from the 1.25 percent Use Tax collected on out-of-state sales.

Downstate Public Transportation Fund	
$170,194,886	**0.5 percent**

CONCLUSION

Most people think of the Illinois Department of Revenue as a state tax collection agency, but one dollar in four that it collects is shared with or collected on behalf of Illinois' many local governments.

Coming Soon: A Discussion of Taxing Consumer Services

The next issue of Tax Facts will contain articles discussing the policy and other implications of subjecting consumer services to sales tax in Illinois. Emotions can run high when this topic comes up; TFI and the contributing authors will present data that may help separate rhetoric from reality.

A few highlights:

- Services are a growing portion of the state and national economy.
- Illinois taxes fewer services than other states, including our neighbors.
- A sales tax is a tax on consumption, and to avoid distortion and tax pyramiding, business-to-business transactions must be excluded from the tax. Our current sales tax generally does this, and any expansion of the tax to services must follow suit.
- Taxing services is not simple and cannot be accomplished quickly or without serious and careful thought.
- Broadening the tax base to include consumer services can mean more revenue for the state, but it does not have to. We can broaden the base and lower tax rates.

Our state's fiscal situation is dire. Some believe we simply need more revenue, while others maintain that we must cut spending and reform government to solve our problems. No matter how that political debate is resolved, policy-makers and the public will focus on taxes sooner or later, and the next issue of Tax Facts is designed to shed some light on one possible area of interest.

How to Evaluate Comparisons and Rankings

By Jim Nowlan; Updated by Carol Portman

Editor's Note: Originally published in the April 2010 issue of Tax Facts, Jim Nowlan's article on evaluating tax burden studies has been updated to reflect more current data.

People are fascinated by comparisons and rankings among the states. The rankings provide context in which to evaluate public finance and performance measures.

Yet comparisons should be viewed with caution. For example, some rankings lack the full context in which they should be evaluated; other rankings include too much in a comparison, effectively comparing apples with oranges. Other rankings fail to appreciate the differing capacities of states to fulfill their financial commitments.

Below we illustrate these cautionary tales and provide readers our perspectives on the most illuminating ways to compare Illinois with other states on financial indicators.

First, compare state and local rankings together, rather than just state rankings alone.

Some analysts compare burdens for *either* the state or local levels of government. Local governments are, however, creatures of the states; residents pay taxes to both state and local governments, and costs of major governmental functions such as education and transportation are shared by the two levels of government. Thus, we find it more telling to compare combined tax burdens of state *and* local governments.

This reporting of combined tax burdens also makes sense because in Illinois the state has traditionally imposed a lighter tax burden than the typical state, while its local governments extract a heavier burden from their residents than in most states. Illinois ranked 23rd among the states in total *state* taxes as a percent of personal income in fiscal year 2012, while Illinois' ranking for *state and local* taxes was 10th (a ranking of #1 would represent the highest taxes).[1]

Illinois' personal income tax is largely a state tax. Illinois ranked 34th in state individual income tax revenue as a percentage of personal income in 2010 (before the 2011 temporary rate increases) and 16th in 2012 (after the rates were increased). On the other hand, property taxes in Illinois are largely a local tax, and we rank 11th highest in 2010 and 9th highest in 2012 terms of property taxes collected as a percentage of personal income.

[1] Unless otherwise noted, the figures in this essay are from the U.S. Bureau of the Census and Bureau of Economic Analysis.

Second, compare states on their respective total *taxes*, rather than on their *total revenues*.

Major state and local taxes are comparable; all states tax some combination of property, income, and sales, and generally all three. Non-tax revenues depend upon the traditions of the respective states, and are somewhat misleading if compared. For example, Illinois has a strong tradition of non-governmental hospitals, often religious in origin; in other states, governments at the regional and local levels have taken responsibility for the hospital function.

As a result, according to the US Census Bureau, in 2011 Illinois governments derived only $1.46 billion from government hospital revenues, whereas neighboring Indiana, with half Illinois' population, generated $2.74 billion from hospital revenues. A few states operate liquor stores, which generate governmental revenues; Illinois does not. Illinois has a tradition of strong, private colleges and universities, which reduces the reliance on state institutions; western states have few private colleges and large public systems.

Possibly as a result of these differences, state to state, in reliance on government to provide functions, the Federal Tax Administrators, using Census Bureau data, found total state and local government revenues in Illinois in 2011 to rank 39th among the states on a percentage of personal income basis. In contrast, Illinois ranks 17th on the more familiar basis of total tax collections.

Third, use *percentage of personal income* or state GDP as the basis for comparison, rather than *per capita* indicators.

Illinois' personal income per capita in 2011 was 104 percent of the national average; Illinois is a little wealthier than average. Connecticut, the wealthiest state, has 136 percent of the national average in per capita income. In contrast, poor states such as Alabama and Mississippi have personal income per capita of just 82 percent and 76 percent, respectively, of the national average.

It would be unfair to compare states with such varied fiscal capacities on measures of, say, tax revenue per capita. Mississippi could have a far higher tax rate than Connecticut and still produce much less per capita than the latter state; measuring tax revenue as a percentage of personal income provides a more even comparison of tax burden.

By the way, use of these indicators tends to lower Illinois' rankings. For example, in 2011 Illinois ranked 15th highest in per capita state and local tax revenue, while we were only 17th on the basis of such tax revenue as a percent of personal income.

Finally, use all rankings and comparisons with some caution.

The dollar differences between a 24th and a 26th ranking may be miniscule, and thus insignificant. More meaningful would be to compare a state's ranking with the top ten states and the bottom ten. This will provide a decent context for understanding tax burdens. Also look closely at the actual fiscal figures listed in the rankings. These figures provide the raw data on which the rankings are based. On some rankings, the spread of the actual figures might be quite narrow; in others, quite broad.

As a final note, it takes time for the data to become available for these evaluations, and law-changes in the 50 states during the intervening years make relying too heavily on comparison even more perilous. In Illinois rankings are in flux as a result of the significant 2011 income tax rate increases which began to roll back on January 1, 2015.

Illinois Tax Facts

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