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February 16, 1981

The Honorable George Sangmeister
1052 Stratton Building
Springfield, Illinois 62706

Dear Senator Sangmeister:

Financing Local Government Through the State Income Tax

This is in response to your inquiry regarding the ramifications of eliminating the local property tax and replacing it with revenues from the state income tax. Specifically you asked for two estimates; one which is based on the elimination of all property taxes imposed by local governmental units and one which is based on the elimination of property taxes imposed by school districts. To accomplish this objective the state's non-graduated individual and corporate income tax rates (Ill. Rev. Stat. 1979, ch. 120, sec. 2-20b) of 2.5 percent and 4 percent, respectively, would have to be increased to levels that will produce the additional revenues. In addition, any increases in these rates will have to conform to the constitutional mandate which provides that the income tax rate on corporations shall not exceed the rate imposed on individuals by more than a ratio of 8 to 5 (Ill. Const., art. IX, sec. 3a).

Property Tax Extension

The total statewide property tax extensions on real and personal property in the 1978 tax year (taxes collectable in calendar year 1979) were about \$4.58 billion. Of this total about \$2.75 billion (approximately 60 percent) was attributable to extensions made by all types of school districts (including community colleges) throughout the state.

In fiscal year 1980 the state's total income tax base of approximately \$95.8 billion produced income tax revenues of about \$2.6 billion. The \$82 billion individual base yielded about \$2.05 billion and the \$13.8 billion corporate base produced about \$550 million.

Income Tax Base and Revenues

If the property tax extensions of all local governmental units throughout the state are to be recaptured through the state income tax, the current 2.5 percent individual rate would have to be increased to 6.9

percent. When multiplied against the \$82 billion individual base, the 6.9 percent rate would produce \$3.61 billion more than the \$2.05 billion currently produced at the 2.5 percent rate. Furthermore, the current 4 percent corporate rate would have to be increased to 11.04 percent. When multiplied against the \$13.8 billion corporate base, the 11.04 percent rate would produce \$971.5 million more than the \$550 million currently produced at the 4 percent rate. These revised rates would yield income tax revenues totaling \$7.18 billion. Approximately \$2.6 billion would be retained by the state as income tax revenues and about \$4.58 billion would be distributed to local governmental units in lieu of the property tax. This distribution scheme reflects the constitutionally mandated 8 to 5 ratio.

If only the property tax extensions attributable to school districts are to be recaptured through the state income tax, the current 2.5 percent individual rate would have to be increased to 5.14 percent. At the latter rate the \$82 billion individual base would produce about \$2.16 billion more than the \$2.05 billion currently produced at the 2.5 percent rate. In addition the current 4 percent corporate rate would have to be increased to 8.22 percent. When multiplied against the \$13.8 billion corporate base the latter rate would produce about \$584 million more than the \$550 million currently produced at the 4 percent rate. Of the \$5.35 billion produced at the revised rates, the state would retain about \$2.6 billion as income taxes and approximately \$2.75 billion would be redistributed to school districts (including community college districts) in lieu of the property tax. This distribution scheme, like the one outlined above, reflects the 8 to 5 ratio mandated by the Illinois constitution.

Neither of these revised corporate income tax rates include the 2.5 percent personal property replacement income tax. Consequently, the total tax rate on corporations under the scheme to replace all property taxes would be 13.54 percent. The total tax rate on corporations under the scheme to replace only property taxes attributable to school districts would be 10.72 percent.

Please let us know if we can be of further assistance.

Sincerely,

RESEARCH DEPARTMENT by

Note: Mr. Minert's signature did not scan by the OCR software.

Charles L. Minert

Senior Research Associate

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Continue to scroll down to see analysis of this report by Joseph R. Oldani.

3/13/1981

Subject: Report Analysis by Joseph R. Oldani

The following comments regarding Financing Local Government Through the State Income Tax were part of the reference material given to the Illinois Senate Revenue Committee Hearing in 1984 as part of Joseph R. Oldani testimony.

I assume the report uses taxable income figures and not adjusted gross income figures for its total income base of \$95.8 billion. The report apportioned this figure to 82 billion individual base and 13.8 billion corporate base. The total statewide property taxes 4.58 billion.

Hypothetical example: The 4.58 billion in property taxes was apportioned to 2.58 billion from individuals and 2 billion from corporate property taxes. Now to find the average percent of individuals' net income they are paying in property taxes divide 2.58 billion by the individuals net income figure 82 billion equals 3.1 percent.

For corporations divide 2 billion by 13.8 billion equals 14.5 percent. The ratio of 8 to 5 used in the state income tax does not equal the ratio of 14.5 to 3.1 for this example. In fact corporations are paying an average of 4.7 times the percent of individuals in property taxes using the income base figures of this report. (14.5 divided by 3.1 equals 4.677)

It is like trying to compare apples to oranges to assume the property tax can be replaced with an income tax using the 8 to 5 ratio. We have to look at the property tax in its present form to see the ratio of corporate to individual replacement income tax. The example suggests the new state income tax percent for individuals are 2.5 plus 3.1 equals 5.6 and for corporations 4 plus 14.5 equals 18.5. Therefore, 5.6% of 82 billion equals 4.6 billion and 18.5% of 13.8 billion equals 2.6 billion for a total of 7.2 billion.

If in fact the corporate portion of the property tax total of 4.58 billion is greater than 2 billion then perhaps some of their tax burden could be shifted to individuals to help improve the corporate climate in the state.

Please have the report expanded in these areas so we may discuss the results further.

1. Apportionment of the 4.58 billion in property taxes for individuals and corporations.
2. Adjusted gross income totals for corporate and individuals. (Not necessary for the forgoing argument)