RECOMMENDATION

7 Reform state and local tax policy

56
Average number of services taxed in all states

12
Number of services taxed in Illinois

$318,000
Highest municipal tax base per capita
(Retail sales + Equalized Assessed Value for municipalities over 5,000 population)

$**8,000**
Lowest municipal tax base per capita
(Retail sales + Equalized Assessed Value for municipalities over 5,000 population)

↑ **27%**
Change in annual state sales tax revenues
(adjusted for inflation)
1992–2008

↓ -15%
Change in annual state gas tax revenues
(adjusted for inflation)

7
Jobs per acre: Auto Dealership

$**107,500**
Local net tax revenue per acre: Auto Dealership

61
Jobs per acre: Corporate Office

$45,900
Local net tax revenue per acre: Corporate Office

$12,000,000,000
Amount of property tax revenue collected by school districts in northeastern Illinois

$**5,000,000,000**
Amount of state tax revenue disbursed to local governments in northeastern Illinois

State and local taxes have an impact beyond the public revenue they raise. To a great extent, they create incentives that shape the commercial and residential development of our communities. Such decisions are often motivated by the imperative of raising local revenues rather than by the goal of building a stronger regional economy and livable communities.

Tax policies frequently distort land use decisions rather than allow markets or quality-of-life factors to guide them. Tax rates are often set very high, and the tax base is overly narrow rather than broad, which further stifles economic competitiveness.

Because the current tax structure of Illinois and metropolitan Chicago is not meeting the needs of our residents and businesses, CMAP recommends the reform of state and local tax policies to make them consistent with the GO TO 2040 plan's vision. The benefits will be substantial in terms of economic development and quality of life in communities across the seven counties.

Reforming these policies can make revenues adequate to support essential public services, while avoiding undesired consequences, such as inefficient land use decisions or inequitable tax burdens that can impair regional economic productivity. The reformed tax system can also achieve greater overall efficiency by minimizing economic distortions created by the current system. And the reforms should bring about improvements in terms of equity, simplicity, and transparency.

Tax policy should encourage local decisions that make effective use of land, generate good jobs, and trigger sustainable economic activity. It should set high standards of transparency and predictability for the taxpayer. And it should not create large inequities across households, businesses, and local governments. By reforming state and local taxation, the region would benefit from new policies that help to advance rather than undermine GO TO 2040's goal for sustained regional economic competitiveness.

CMAP recommends the following areas be fully analyzed for potential reform.

Existing State and Local Revenue Sharing Arrangements, with a Specific Focus on the Sales Tax
Currently, nearly $5 billion annually in state tax revenue is disbursed to local governments in northeastern Illinois based on various criteria. More than one quarter of this amount comprises sales tax revenue shared between the state and municipalities, which receive 16 percent of the sales tax collections based on local point of sale. This disbursement structure creates an incentive for many local governments to emphasize retail land use — such as the attraction of auto dealerships and big box stores — perhaps at the expense of other uses more beneficial to the regional economy — such as offices or industrial uses. These revenue sharing structures should be addressed and adjusted to support economic efficiency and fairness.

Sales Tax and the Service Sector
Currently, the State of Illinois taxes many goods but only a few services, which make up a much larger and growing portion of the economy. Services make up 70 percent of personal expenditures today, substantially more than 40 years ago, when goods and services were roughly equal. Expanding the sales tax to include some types of industries in the service sector will expand the tax base, which could also allow lower sales tax rates without reducing overall revenue. It also will make the sales tax more progressive, because low-income earners consume more goods relative to their incomes than do high income earners.

Property Tax Caps, Classification, and Exemptions
Property taxes provide vital revenues for local government services, yet the systems in our region are often saddled with complexities and incentives that distort economic decision making and place undue stress on households, businesses, and local governments. Statutory and constitutional limitations on the property tax include tax caps (the Property Tax Extension Limitation Law, or "PTELL"), differing assessment classifications in Cook County, and other exemptions. These limitations can alter residential and business location decisions, create unpredictability for the taxpayer, and undermine local control. The property tax systems in northeastern Illinois need to be simplified and the process should be more transparent.

State Income Tax
The state's individual and corporate income tax rates (three percent and 4.8 percent, respectively) are among the lowest rates in the U.S. The tax is also imposed on a flat rather than graduated basis, whereby tax rates would be applied based on income levels. Moving to a graduated state income tax system, with marginal rates, could not only raise more revenue but also make the overall tax system more progressive. In addition, the state income tax base remains narrower than most other states due to its exemption of most retirement income, including public and private pensions.

Local Tax Capacity
Some areas within the region have a much larger economic base than others, which gives them a greater "tax capacity." While this should be expected to some extent in any metropolitan area, extreme divergences render many local governments helpless in terms of providing essential services and attracting new residents and businesses. Moreover, this divergence is anticipated to grow over time, as municipalities endowed with strong revenues can keep property tax rates lower while also providing quality services and infrastructure. A strong and sustainable region must address how tax policies can often hinder the future economic well-being of many of its communities.

The following section describes current conditions, explains the importance of reforming tax policies, and provides details about the recommended actions. The overall desired outcome is for state and local tax policies to serve their intended role — efficient and effective financing of public services — without impeding the overall economic competiveness of the region.

7.1 Benefits

Local tax policies address various themes from the Regional Vision, most prominently the strength of the regional economy, sustainability, equity, and intergovernmental coordination and planning. The vision states that "leaders will recognize the interdependence of our communities and will work across political boundaries to address issues facing multiple jurisdictions."

State and local tax policy exemplifies one of these issues. From a regional planning perspective, it is vital to understand the dynamics of tax policy especially in terms of their potential impacts on development decisions and regional economic productivity.

The following sections describe some benefits of addressing state and local tax policy issues.

Economic

A burdensome, complex, or unpredictable taxation system is likely to have negative economic consequences for households, businesses, and local governments. Poorly designed tax systems tend to distort residential or business location decisions, with subsequent ripple effects throughout the overall regional economy. States, metropolitan regions, and local governments can all enhance their business climates (and improve livability for residents) through predictability, transparency, and fairness in taxation. Furthermore, an overreliance on some forms of taxation — like the sales tax, which usually mirrors fluctuations in the economy more closely than the property tax — can lead to deficits and an inability to deliver key services at times when residents and businesses need those most.[1]

To keep tax rates low and economically competitive, the tax base must also be broad. A "broad tax base" is one with few exemptions or limitations among different businesses, services, or properties. GO TO 2040's tax policy recommendations would seek to broaden the tax base (for example, by applying the sales tax to some services), limit land use distortions associated with the property and sales tax, and make the system more predictable and transparent, all of which should lead to a better economic climate for residents and businesses.

1 For a more thorough description of the stability of the property tax relative to other sources like the sales tax, see David Brunori, "Local Tax Policy — A Federalist Perspective," (The Urban Institute Press, 2003).

Land Use

Local governments have a strong incentive, particularly in today's difficult fiscal climate, to orient land use planning and decision-making to maximize local tax revenues. In some other states, particularly California (which places more extreme caps on the ability of municipalities to raise local property tax revenues), the orientation of land use decisions to maximize the sales tax has been dubbed the "fiscalization of land use." This occurs when municipalities choose retail and other industries that generate local tax revenues rather than industrial or office uses that generate more jobs or grow the metropolitan economy. In northeastern Illinois, state and local sales tax revenues generated by retail land use are vital for ensuring the fiscal health of many local governments. Without harming local government abilities to raise adequate revenue, altering the dynamics of the current state/local sales tax disbursement arrangement may generate development patterns that are less distortive and more sustainable regionally.

Equity

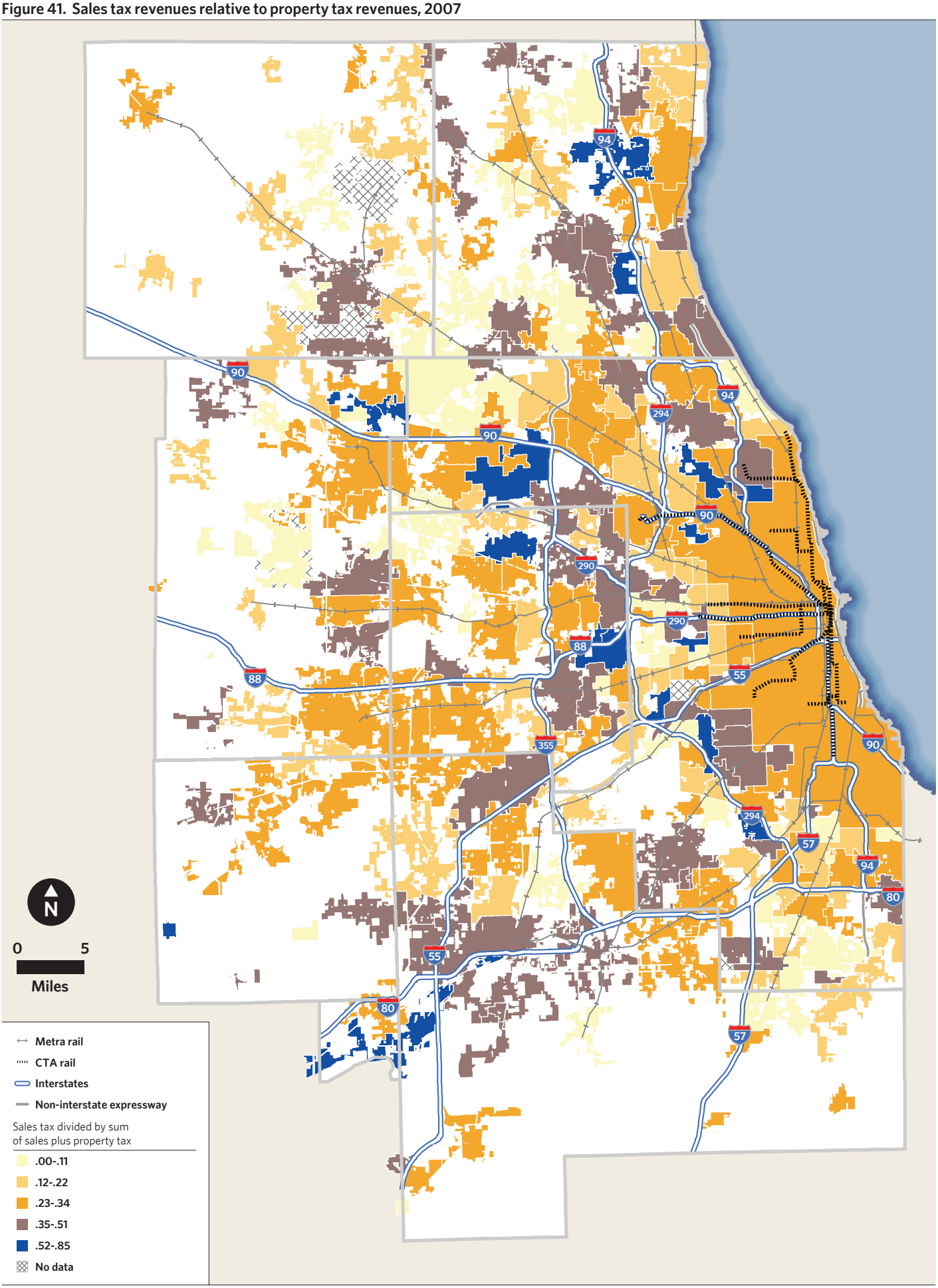
While equity can be defined in different ways, it is generally agreed that taxes and fees should strive for two different principles. The first, "horizontal equity," means that similar people and firms should share similar burdens. The second, "vertical equity," means that the tax system should be based on the entity's ability to pay. Vertical equity is consistent with a tax system that tends toward the progressive rather than the regressive. GO TO 2040's tax policy recommendations, on the whole, strive to uphold these principles. Expanding the sales tax to services, graduating the state income tax, and addressing property tax classification and exemption issues will all have a positive impact on equity. Furthermore, addressing state and local revenue sharing arrangements should not only positively impact the economy, but it should also positively impact the ability of all local governments, including those in the most economically disadvantaged parts of our region, to provide needed services.

Governance

The reliance on the property and sales tax in northeastern Illinois can set the stage for competition over development and tax revenues. Many businesses that can move relatively cheaply within the metropolitan region may do so in order to take advantage of tax differentials. This can sometimes pit one local government against another in terms of business attraction or retention efforts, and oftentimes taxpayer dollars are expended in the process, with little or no positive impact to the region's economy.[2] GO TO 2040's tax policy recommendations seek to address the degree to which tax policies incent local competition, rather than cooperation, throughout the region. In particular, reforming the current state sales tax disbursement criteria away from a sole focus on local point of sale should lessen the degree of local competition of certain types of development.

2 For more information on local tax incentives, see GO TO 2040 Economic Development Incentives Strategy Paper, 2009. See **http://www.goto2040.org/incentives/**.

Figure 41. Sales tax revenues relative to property tax revenues, 2007



This map shows municipal state & local sales tax revenues (2007) divided by the sum of sales tax and derived property tax levies (2007). Derived property tax levies include municipal plus predominate park, library, and fire districts. Darker shading indicates a higher reliance on sales tax relative to property tax. Lighter shading indicates a higher reliance on property tax.
Sources: Illinois Department of Revenue and County Clerk's Offices.

7.2 Current Conditions

In northeastern Illinois, over 1,200 units of government collect revenues and provide services to residents, businesses, and visitors. Compared to other Midwest and Northeast states, the State of Illinois and local governments remain more reliant on sales and property tax, and less reliant on the income tax.

But our region's local governments, particularly our municipalities, vary widely in terms of reliance on revenue sources. One striking variation is the reliance on state and local sales tax revenues, relative to the property tax (see **Figure 41**).

State and local tax policies in Illinois and the CMAP region often fail to satisfy the most important principles of good tax policy: efficiency, equity, and transparency. A "good" system of taxation is typically one with a broad base and low rates that do not create de facto incentives for inefficient decisions regarding the location of residential and commercial development. GO TO 2040's emphasis on the regional economy, sustainability, and intergovernmental coordination requires serious consideration of our region's particular reliance on the sales and property tax, the mechanics by which these and other taxes are administered, and other issues related to state and local revenue sharing arrangements.[3]

The following subsections describe several imperative action areas of state and local tax policy.

State and Local Revenue Sharing

In 2008, local governments in northeastern Illinois received over $4.2 billion in state revenue through various arrangements typically referred to as "state and local revenue sharing."[4] The criteria for these disbursements vary considerably across the revenue sources, as shown in **Table 4**. For instance, sales tax is allocated on the basis of local retail sales, while income tax allocations are based on population. Allocations of other revenue sources like the Motor Fuel Tax (MFT)[5] and Personal Property Replacement Tax (PPRT) rely on formulas that are complex (in the case of the MFT) or are based on antiquated metrics (in the case of the PPRT). The main policy question is whether such revenue sharing formulas promote desired regional outcomes such as economic productivity, efficient development patterns, and equity.

3 For a comprehensive survey of existing conditions, see the CMAP State and Location Taxation Snapshot, 2009. See **http://www.cmap.illinois.gov/snapshot.aspx#Tax**.

4 Illinois Department of Revenue, Monthly Detailed Disbursement Amounts. This figure does not include local option sales tax revenues, which are also collected by the state for the local governments that impose them.

5 Given its inherent connection to transportation policy, the state motor fuel tax is discussed in greater detail in the GO TO 2040 section titled "Invest Strategically in Transportation."

Table 4. Examples of state/local revenue sharing arrangements in the State of Illinois

STATE TAX SOURCE	HOW IMPOSED	LOCAL GOVERNMENTS RECEIVING DISBURSEMENT	DISBURSEMENT FORMULA	AMOUNT DISBURSED TO LOCAL GOVERNMENTS IN NORTHEASTERN ILLINOIS (2008)
Sales Tax	6.25% state rate for retail sales of general merchandise and 1% state rate for sales of qualifying food, drugs, and medical appliances.	Counties, municipalities, and the Regional Transportation Authority*	16% of the state collections from retail sales of general merchandise and 100% of the collections from sales of qualifying food, drugs, and medical appliances are returned to the municipal or county government (if unincorporated) where the sale took place. 4% of the tax collected from general merchandise sales is disbursed to county governments (except Cook County) for sales that occurred anywhere within their county boundaries. For sales made in Cook County, this 4 % share is allocated to the RTA.	$1.9 billion**
Personal Property Replacement Tax	Corporations pay 2.5% tax on income, partnerships, trusts, and S-corporations pay 1.5% tax on income, and public utilities pay 0.8% tax on invested capital. The PPRT is submitted along with state income tax payments.	All taxing units of government †	The total collections are divided into two portions. One portion (51.65%) goes to Cook County. The other portion (48.35%) goes to other counties. The Cook County portion is then distributed to the taxing districts in Cook County on the basis of each district's share of personal property tax collections for the 1976 tax year. (For example, if total taxes collected by all districts were $1 million and District A collected $35,000 of that total, District A's share of any future distributions would be 3.5%.) The downstate portion is distributed similarly, except that the collections from the 1977 tax year are used to calculate each district's share of the distribution.	$1 billion
Income Tax	Individuals, trusts, and estates: 3% of net income; Corporations: 4.8% of net income.	Counties and municipalities	One tenth of total collections minus the amount deposited in the refund fund. The amount that each municipality or county receives is based on its population in proportion to the total state population.	$792 million
Motor Fuel Tax	$0.19/gallon for gasoline and gasohol, $0.215/gallon for diesel and $0.215/gallon for combustible gases.	Counties, municipalities, townships	After a variety of deductions, 54.4% of the balance is allocated to local governments. Of this portion, 49.1% is distributed to municipalities, 16.74% to counties over 1,000,000 in population, 18.27% to counties under 1,000,000 in population, and 15.89% to townships. The municipality's share of the total MFT allocation is based on population. The county share is based on the amount of motor vehicle license fees received. The road district/township share is based on mileage of township roads. MFT funds must be used for transportation purposes.‡	$377 million
Telecommunications Tax	Imposed by local ordinance or resolution in 1/4% increments with a 6% maximum rate limit.	Municipalities	After taking a 1/2% administrative fee retained by the state treasurer, the Illinois Department of Revenue administers and disburses the full value of the tax revenue collected.	$216 million

* The RTA sales tax rate was increased 0.25 percent in Cook County and 0.50 percent in the collar counties effective April 1, 2008. The RTA receives Cook County government's portion of the disbursement share from the state. In addition, the RTA imposes additional rates in Cook County and the collar counties — but these are not part of the disbursement from the base sales tax rate of 6.25 percent.

** This figure does not include home rule/non home rule sales taxes, which are also disbursed (in full) by the IDOR to the municipalities and counties which impose them.

† The Personal Property Replacement Tax disbursement formula is extremely complex. See the Illinois Department of Revenue fact sheet on this issue at **http://www.revenue.state.il.us/LocalGovernment/Overview/HowDisbursed/replacement.htm**

‡ Eligible uses can be found in **http://www.dot.state.il.us/blr/mftbooklet.pdf**

Source: Illinois Department of Revenue — "General Overview — How Local Tax is Disbursed"

Sales Tax and the Fiscalization of Land Use

Sales tax generates just over one-third of all state revenue collections (over $10 billion was collected in FY 2008[6]). It is also the largest of the state and local revenue-sharing disbursements. The state re-allocates to a municipality one percent of retail sales within its borders, corresponding to 16 percent of the state's 6.25 percent sales tax rate. In 2008, these disbursements totaled roughly $1.1 billion for northeastern Illinois municipalities.[7]

This structure creates an incentive to attract retail land use and may lead many local governments to overemphasize retail, perhaps at the expense of other economic activities more beneficial to the region. It rewards communities that have the point of sale but not others that were involved in the economic process, because manufacturing, distribution, and corporate offices provide no sales tax revenues unless the point of sale coincides in these locations. Because the region's ability to support retail is finite, the need for this revenue may be one (though not the only) major driver of counterproductive local competition and unfocused growth in parts of the metropolitan area.[8] **Figure 42** shows the percent change in these revenues, in constant 2008 dollars, between 2003 and 2008. The map indicates a trend of high sales tax growth (shown in blue) in communities located at the outer edge of the region, while older communities experienced lower rates of growth, or in many cases, actual declines.

Table 5 shows the results of a fiscal and economic impact analysis of four different land uses. Because each would result in large-scale development with significant impacts, contrasting them can help to highlight the fiscal and economic disparities associated with current tax policies. The analysis assumes that a typical Chicago-area municipality possesses a 30 acre greenfield site with good access and visibility that could be developed under one of four scenarios:

1. **Retail power center (typically anchored by a home improvement store, warehouse club, or office supply store)**
2. **Auto dealership**
3. **Corporate office park**
4. **"Light" industrial (e.g., distribution center or manufacturing)**

The tax, jobs, wage, and other economic data used for the fiscal and economic impact analysis are specific to the metropolitan Chicago region.

"Fiscal impacts" include municipal revenues (sales, property, telecom, electricity, and natural gas taxes) and expenses (general fund, fire, police, and public safety services). "Direct impacts" are generated by the project itself (i.e., new employees hired to work at each establishment) and "indirect impacts" are caused by local economic activity triggered as the business(es) associated with the development purchase goods and services nearby. All impacts are given per acre.

Table 5. Fiscal and economic impact comparison by acre

	RETAIL POWER CENTER	AUTO DEALERSHIP	CORPORATE OFFICE	INDUSTRIAL
Fiscal Impacts				
Fiscal Revenues/Acre	$62,200 - $85,600	$92,700 - $111,400	$23,500 - $68,400	$4,500 - $6,700
Fiscal Expenses/Acre	$9,900	$3,900	$22,500	$3,500
Net Fiscal Impact/Acre	$52,300 - $75,700	$88,900 - $107,500	$1,000 - $45,900	$1,000 - $3,200
Direct Economic Impacts				
Direct FTE Jobs/Acre	16	7	61	11
Direct Wages/Acre	$573,100	$452,900	$6,873,700	$814,000
Indirect Economic Impacts				
Indirect FTE Jobs/Acre	6	4	80	17
Indirect Wages/Acre	$334,700	$231,900	$4,490,900	$1,065,700
Total Regional Output/Acre	$2,649,500	$1,736,600	$31,165,000	$7,892,400

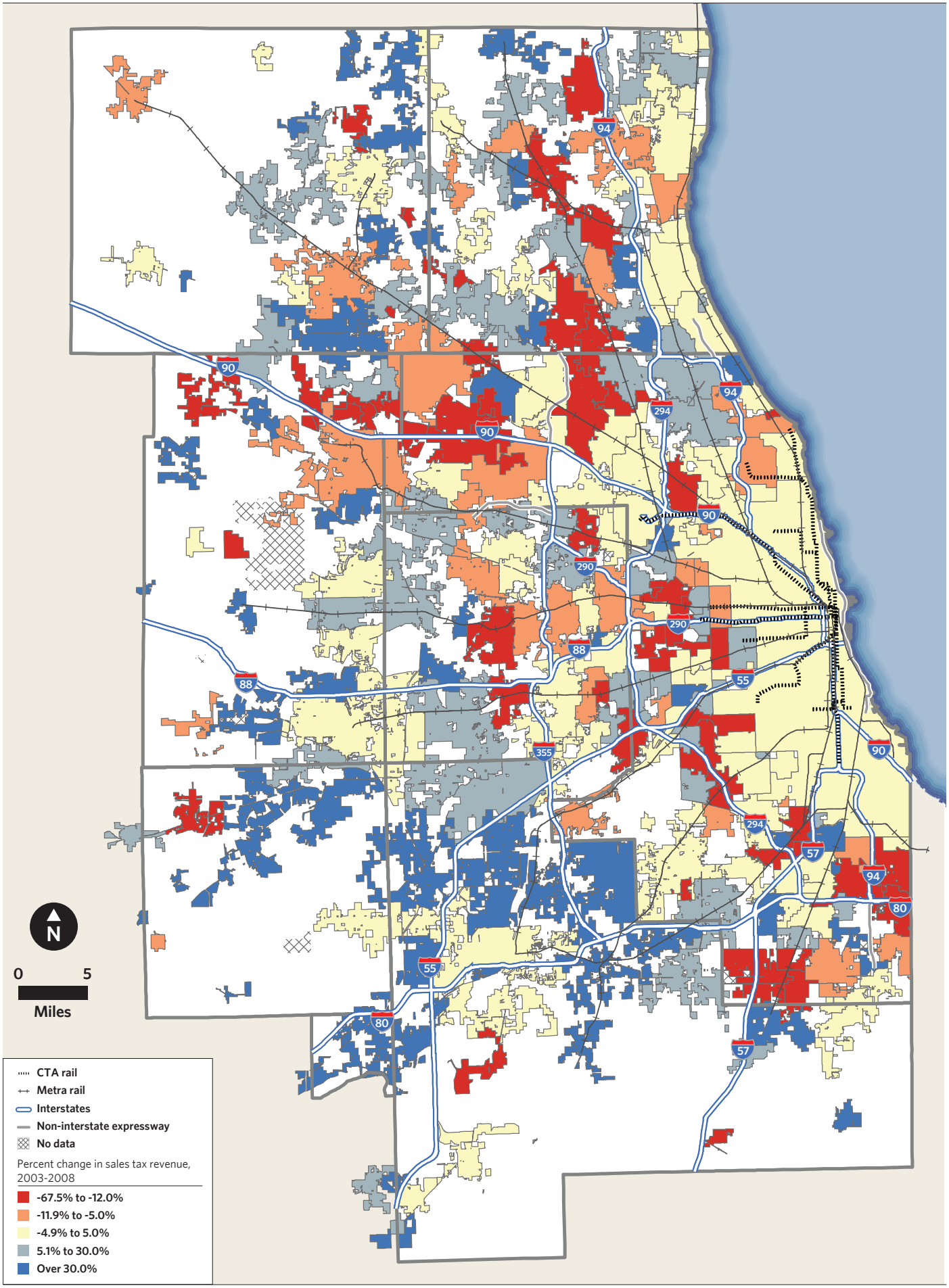
Sources: Minnesota IMPLAN Group, Bureau of Labor Statistics, and S. B. Friedman & Co. Data is specific to the suburban Chicago region and is from 2006-2009.

6 Illinois Department of Revenue, Annual Report of Collections and Distributions, 2008.

7 Illinois Department of Revenue, Monthly Detailed Disbursement Amounts.

8 See 1) Paul G. Lewis, "Retail Politics: Local Sales Taxes and the Fiscalization of Land Use," *Economic Development Quarterly*, 15 (1; 2001): 21-35; 2) Paul G. Lewis, and Elisa Barbour, "California Cities and the Local Sales Tax," (Public Policy Institute of California, 1999); 3) Robert W. Wassmer, "Fiscalization of Land Use, Urban Growth Boundaries, and Non-Central Retail Sprawl in the Western United States," *Urban Studies* 39 (8, 2002): 1307-1327; 4) Robert W. Wassmer, "The Influence of Local Urban Containment Policies and Statewide Growth Management on the Size of United States Urban Areas," *Journal of Regional Science* 46 (1, 2006): 25-65; 5) Michael C. Pagano, "City Fiscal Structures and Land Development," (Brookings Institution Center on Urban and Metropolitan Policy, 2003) ; 6) David Newell and Jennifer Robinson, "Local Economic Development: Importance of Sales Tax and Other Factors," University of Utah Center for Public Policy and Administration and the Utah Foundation, *Policy-In-Depth* paper series, number: 04-15-2008.

Figure 42. Percent change in municipal share of state sales tax revenue for CMAP municipalities, 2003-2008



This map shows the percentage change in state sales tax disbursements to municipalities. Local option sales tax revenues are not included. Measured in 2008 constant dollars.
Source: Illinois Department of Revenue

These results indicate a significant difference between the retail and auto uses, which generate high sales taxes, versus the office and industrial uses. In fact, the single most important factor driving the high net fiscal impact for retail and auto is the sales tax these uses generate. Retail and auto dealerships actually generate very little in other taxes, relative to the corporate office use (industrial generates fewer tax dollars across the board). While a retail power center and an auto dealership cluster are estimated to generate significantly more tax dollars at the municipal level, they generate jobs with lower salaries and have much lower economic output than the office and industrial options. In other words, local governments have powerful financial incentives to attract types of businesses that do not have the greatest economic contributions. These results highlight the potential for disparity between local land use decisions and regional planning for jobs and industry.

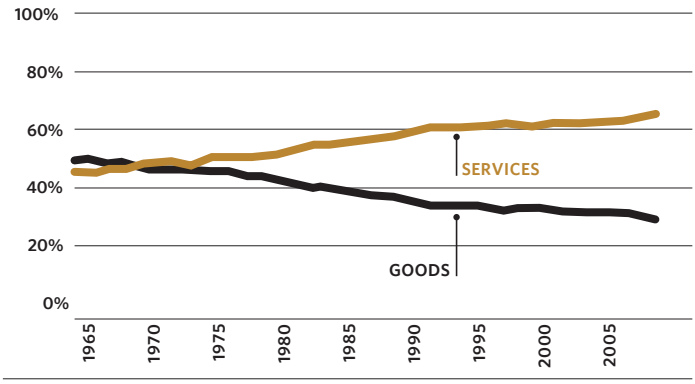
Sales Tax and the Service Sector

The service sector represents a large and growing portion of the regional economy. Today 68 percent of personal consumption expenditures consist of services, up from 48 percent nearly a half century ago.[9] Sales taxes were originally imposed by many states in the 1930s, when services accounted for only a small fraction of economic activity. As the economy has become more service-oriented over time, states like Illinois should respond accordingly by broadening the tax base to account for this changing dynamic, as shown in **Figure 43**.

The economy of Illinois has largely mirrored that of the U.S. as a whole in terms of service sector growth. Today, service sector industries make up nearly 44 percent of the total Illinois economy today, up from 30 percent in 1975. Furthermore, Illinois currently taxes only 17 services, which ranks 47th lowest in the U.S.[10] Illinois predominately taxes utilities services, but not business services, personal services, or repair and installation services, which are all taxed to a greater degree by most other states.

Extending the sales tax to more services could raise considerable revenue, or be structured to be revenue-neutral through a corresponding lowering of overall sales tax rates. Expanding the sales tax to some services could also limit the highly regressive nature of the sales tax, as lower-income people typically spend a higher percentage of their incomes on everyday necessities (which are largely goods and thus taxed) than higher-income people do. One illustrative example is household lawn care. Lawn-mowing equipment (as goods) is taxed, while lawn services and landscaping (services more likely to be hired by high income earners) are not.

Figure 43. U.S. personal consumption expenditures, 1965-2009



Source: U.S. Department of Commerce, Bureau of Economic Analysis, Personal Consumption Expenditures by Major Type of Product.

9 Bureau of Labor Statistics, Personal Consumption Expenditures by Major Type of Product, 2009.

10 Commission on Government Forecasting and Accountability of the Illinois General Assembly, Service Taxes, 2009 Update, August 2009.

Property Tax Classification, Limitations, and Exemptions

Assuming a well-designed system, the property tax is an effective and efficient means of raising local revenues.[11] With over $18 billion in annual revenues generated, it also constitutes the largest source of funding for the local units of government in northeastern Illinois. Property tax revenues skew heavily toward the region's school districts, which collect over 60 percent of the total revenues.[12] Many municipalities, as well as most townships and other special taxing districts, are also highly reliant on the property tax. Virtues of the tax include its stability and reliability, ease of administration, and the intrinsic connection between the source of revenue (property) and what is being provided in return (public services).

However, the property tax system in northeastern Illinois can also be quite complex. In some parts of the region, and particularly in Cook County, the property tax system does not satisfy the important principles of horizontal equity, transparency, adequacy, or sustainability.

Cook County assesses commercial property at a higher percentage of market value than residential property. This "classification" differs from the collar counties, which assess both commercial and residential property at the same percentage. The main impact of this arrangement is to shift the property tax burden toward businesses in Cook County.[13] Furthermore, Cook County's Seven Percent Expanded Homeowner Exemption, which in recent years has been shown to shift the tax burden away from homeowners and toward other property owners,[14] is currently being phased out. The future ramifications of both of these policies are extremely difficult to predict and generate considerable confusion and uncertainty for many residents and businesses in Cook County.

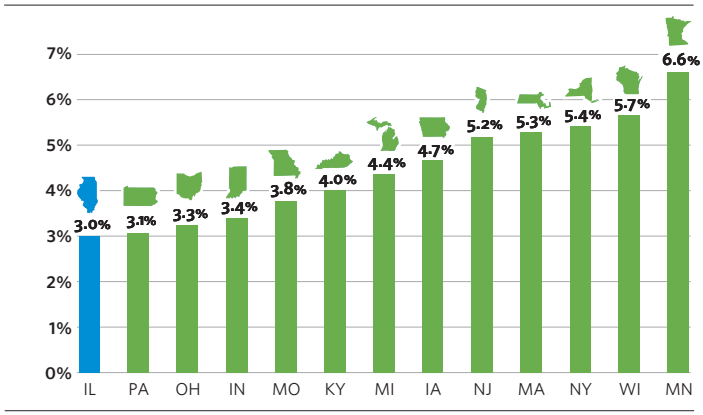
The state's Property Tax Exclusion Limitation Law (PTELL) also limits property tax extensions for most non-home rule governments, including municipalities, townships, and school districts. This is an important policy issue because the tax cap serves to constrain some local revenues but not others, which may lead local governments toward reliance on less efficient and effective revenue sources, such as the sales tax, to fund government services. Furthermore, PTELL is based on limiting exemptions to the lesser of five percent or the increase in the Consumer Price Index (CPI). In difficult economic climates with zero or negative inflation, local governments can barely raise property tax extensions at all.

State Income Tax

As the largest revenue source for the State of Illinois, income taxes generate over half of total state revenue collections — nearly $15 billion was collected in FY 2008.[15] Roughly a tenth of these collections are disbursed to counties and municipalities based on population. While the state income tax does not have the same local land use implications of the sales and property taxes, it comprises a substantial portion of the state's annual budget. Illinois has one of the lowest individual (three percent) and corporate (4.8 percent) income tax rates in the U.S. (see **Figure 44**). It also remains one of if not the least progressive income taxes in the U.S., due to its flat rate application.[16] Most states opt instead for a graduated system, which expands tax capacity with marginal rates for different brackets based on ability to pay. In Illinois, the approval of a state constitutional amendment would be required to authorize a graduated rather than flat income tax.

The state income tax base also remains narrower in Illinois relative to most other states because Illinois exempts most retirement income. While a majority of states (including Illinois) exempt Social Security income, Illinois is one of only ten states to fully exempt public pension income, and one of only three states to fully exempt private pension income.[17]

Figure 44. Individual income tax rates by state



Ohio, Missouri, Kentucky, Iowa, New Jersey, New York, Wisconsin, and Minnesota have graduated income tax rates — for the purposes of this chart, the average graduated rate is given.

Source: The Tax Foundation, "Facts and Figures Handbook — How Does Your State Compare?"

11 The property tax does have vertical equity considerations, a full examination of which is beyond the scope of this recommendation.

12 Illinois Department of Revenue, Property Tax Extensions by Type of District, 2007.

13 Civic Federation, "State of Illinois Constitutional Convention Fiscal Issues," April 10, 2008. See **http://civicfed.org/sites/default/files/civicfed_271.pdf**.

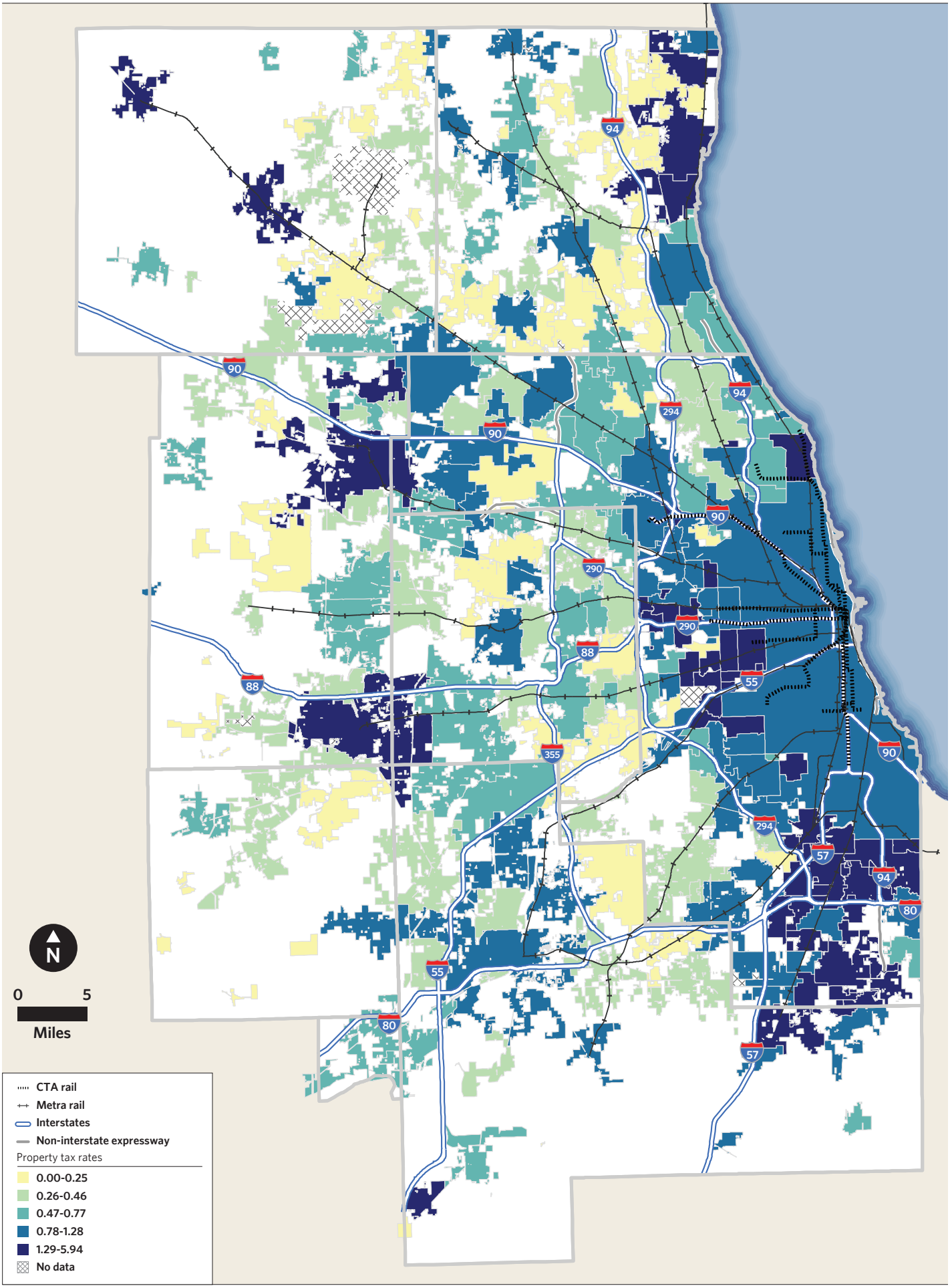
14 Civic Federation, "Effects of the 7% Cap on Property Tax Paid in Cook County: 2002-2008," March 26, 2007. See **http://bit.ly/bq6c2b**.

15 Illinois Department of Revenue, Annual Report of Collections and Distributions, 2008.

16 Institute on Taxation and Economic Policy, "Ready, Set Reform: How the Income Tax Can Help Make the Illinois Tax System Fairer and More Sustainable," May 2009.

17 The Institute for Illinois' Fiscal Sustainability at the Civic Federation, "A Fiscal Rehabilitation Plan for the State of Illinois," February 22, 2010.

Figure 45. Municipal property tax rates, 2007



Source: County Clerk's offices

Local Tax Capacity

Some areas within the region have a much greater economic base than others, hence a greater "tax capacity." While this should be expected to some extent in any metropolitan area, extreme divergences render many local governments helpless in terms of providing essential services and attracting new residents and businesses. Moreover, this divergence is anticipated to grow over time, as municipalities well endowed with strong revenues can keep property tax rates lower while also providing quality services and infrastructure, essential ingredients for attracting and retaining residents and businesses.

Figure 45 shows the wide divergence in property tax rates across the region. Many communities are able to keep property tax rates extremely low (and some do not even impose a property tax). Other communities impose much higher rates. High rates are often required to generate sufficient revenues from a base of low assessed value properties. The impacts of these inequities on school funding should not be ignored. Reliance on the property tax for school funding is related to large inequities in per-pupil spending across the region.

7.3 Indicators and Targets

The most important outcomes driving the reform of state and local tax policies should include a higher gross state and regional product, increased levels of business investment, higher paying jobs, and increased equity (both horizontal and vertical) across local governments, businesses, and households.

Unfortunately, isolating the causal impact of tax reforms upon these outcomes remains elusive. Thus, the indicators used to track progress should align more closely with metrics of "good tax practices" rather than the more important economic or equity outcomes impacted by multiple variables beyond taxation.

Suggested indicators to track progress include:

Efficiency of the Tax System
An efficient tax system minimizes economic distortions by having a broad rather than narrow, tax base. A broad tax base is one with few exemptions or limitations. The result is that similar households and businesses are taxed in similar ways. A broad tax base also allows for lower tax rates, which can enhance economic competitiveness. This metric should judge the region's success in broadening the tax base (e.g., in regards to the sales tax, number of services taxed) as well as lowering tax rates.

Equity of the Tax System
A tax system should strive for two different principles. The first, "horizontal equity," means that similar people and firms should share similar burdens. "Vertical equity" means that the tax system should be based on the entity's ability to pay. Vertical equity is consistent with a tax system that tends toward the progressive rather than the regressive. CMAP proposes measuring the regional equity of tax system in terms of local government revenues per capita. The Gini coefficient, a metric for measuring equity, can be used to quantify the equity of municipal government revenues per capita across the region.

Transparency of the Tax System
The public should have access to the most up-to-date state and local taxation and other fiscal data. The data should include revenues and expenditures by type. Data should be made available online.

7.4 Recommendations

The development of specific recommendations to address the issues of state and local tax policy should take further shape through the creation of a **Regional Tax Policy Task Force**.

This group will report to the CMAP Board and be housed at CMAP. Membership on this new group would include state and local government officials, academic experts, the business community, and other civic organizations.

The task force will exist to advise the Board and will have no statutory or independent authority. The CMAP Board will have ultimate discretion in terms of recruiting, forming, and managing this task force. The CMAP Board will also ensure that the group's research and recommendations reflect the varied challenges faced by local governments, residents, and businesses across the region. The group should conclude its work within 18 months of formation.

Broadly speaking, the task force will be charged with addressing issues central to state and local fiscal policy, viewed through the lens of the regional economy, sustainability, equity, and the connections between tax policies and development decisions. Recommendations might propose reforms to state law and/or suggest regional or subregional actions for improving the efficiency, equity, and transparency of the tax system. GO TO 2040 fully recognizes that state and local tax policy is a complex topic that requires prudence, since certain policy changes can lead to shifting burdens across residents, businesses, and governments.

The 14 members of the Regional Tax Policy Task Force should include state and local government officials, academic experts, the business community, and other civic organizations. In making its appointments, the Board should ensure that the Task Force's membership is balanced, including appropriate representation by geography, as well as representatives who understand the perspectives of both home-rule and non-home-rule governments. Its composition should be as follows, with specific membership subject to approval by the CMAP Board:

- **Two representatives from the State of Illinois**
- **Four municipal representatives, including one from the City of Chicago, one from the Cook County suburbs, and two from the collar counties**
- **Two county representatives, including one from Cook County**
- **Two public finance policy experts from academia who have conducted scholarly research on taxation issues in northeastern Illinois**
- **Two members from the business community to represent the private sector**
- **Two members from local civic organizations well-equipped to research and discuss matters of state and local taxation**

GO TO 2040 recommends the following topics for more thorough exploration by this group.

State and Local Revenue Sharing, with Emphasis on the Sales Tax

The Task Force should analyze the impacts of state and local revenue-sharing arrangements and recommend appropriate adjustments to the various disbursement formulas. Two overarching principles that may be used to analyze the disbursement criteria are 1) whether the formulas promote the most optimal and sustainable economic and development outcomes and 2) whether they achieve some degree of fairness across local governments. Particular attention should be paid to the criteria of local retail sales as a disbursement mechanism for the sales tax, given the likely land use implications. Further research should elucidate these impacts, as well as the regional economic and development ramifications of the sales tax disbursement formula.

Sales Tax and the Service Sector

The Task Force should analyze potential impacts of the state expanding the sales tax base to cover a number of appropriate services. Any change should be made incrementally and cautiously, so the Task Force should carefully assess the efficiency, equity, revenue potential, and administrative costs of instituting such a policy change. If administered with care, expanding the sales tax to the service sector would broaden the tax base, increase revenues, and reduce the regressive nature of the sales tax.

Property Tax: Classification, Limitations, and Exemptions

The Task Force should address Cook County's system of residential and commercial property tax assessments. This system should be simplified, and the process should be made more transparent to the taxpayer. Without sacrificing transparency, local governments across northeastern Illinois should enjoy wider latitude regarding property taxes, with fewer restrictions by the State of Illinois. Furthermore, the Task Force should consider effects of the PTELL on communities in northeastern Illinois and recommend modifications to the legislation where appropriate. Although voters can approve tax increases above PTELL, fiscal policy by means of referenda has often proved to be ineffective in other parts of the U.S.

State Income Tax

The Task Force should analyze the efficiency and equity of the state income tax. While the state's individual and corporate tax rates (3 percent and 4.8 percent, respectively) are among the lowest rates in the U.S., the more critical long term issues include the flat rate structure and narrow base of the tax. The flat rate structure imposes the same rate for all taxpayers regardless of ability to pay, and the narrow base of the tax is reflected in the exemptions granted to pensions and other retirement income. Moving toward a graduated system (with marginal rates for different tax brackets), and limiting these exemptions can improve efficiency and equity and raise more revenue without raising rates across the board. It is important to recognize that in Illinois, the approval of a state constitutional amendment would be required to authorize a graduated, rather than a flat, income tax.

Local Tax Capacity

The Task Force should analyze state and local tax policies' ramifications for equity in northeastern Illinois. It should be stressed that some of the GO TO 2040 tax-reform recommendations should improve intraregional equity by broadening the tax base and modifying certain taxes (sales and income tax) to make them more progressive in nature.

7.5 Implementation Action Areas

GO TO 2040 focuses on one major implementation area for state and local tax policy: the creation of a Regional Tax Policy Task Force that will be housed at and staffed by CMAP, answering to the CMAP Board.

The table below summarizes specific steps to be taken by this group and lists the state and local tax policy issues that CMAP considers high priorities for reform.

7.6 Costs and Financing

CMAP's tax policy recommendations do not focus on raising tax rates or on increasing net revenues through taxes for state and local governments.

While sustainable fiscal health and balanced public-sector budgets are crucial for attaining overall GO TO 2040 objectives, CMAP is most concerned with how the current tax system is helping or hindering economic competitiveness and equity in the region. The reforms suggested in this recommendation can be structured to be "revenue-neutral." An example of this is extending the sales tax base to some industries in the service sector. Broadening the base to services, all else equal, would increase revenue. However, rates can then be lowered to achieve a revenue-neutral outcome.

Implementation Action Areas

Create task force LEAD IMPLEMENTERS: CMAP	Membership on the task force should include local governments, academic experts, civic organizations, and the business community. The CMAP Board will have ultimate discretion in terms of recruiting, forming, and managing this group. CMAP will provide staff support to the task force and CMAP staff will lead the development of policy briefs, reports, and analysis on these matters.
Evaluate state and local revenue sharing criteria with particular emphasis on the sales tax LEAD IMPLEMENTERS: Task Force, CMAP Board, State, counties, municipalities	More than $4 billion in state tax revenue, much of which is made up of sales tax, is disbursed annually to local governments in northeastern Illinois. Evaluate state/local revenue sharing criteria including the sales tax, income tax, personal property replacement tax, and MFT. The task force should analyze the fiscal, economic, and equity impacts of altering disbursement criteria and make appropriate recommendations to the state and/or propose regional or subregional actions. The sales tax disbursement, which is based on local retail sales, should receive particular emphasis. Prepare detailed recommendation.
Evaluate property tax classification and the property tax extension limitation law LEAD IMPLEMENTERS: Task Force, CMAP Board, State, Cook County	Evaluate the property tax classification system in Cook County and propose reform, where appropriate. Special attention should be paid to impacts on businesses and households as well as residential and commercial location decisions. Evaluate the impacts of PTELL on local government revenues and services and propose reform, where appropriate. Prepare detailed recommendation.
Evaluate expanding the sales tax to the service sector LEAD IMPLEMENTERS: Task Force, CMAP Board, State	Evaluate the impacts of extending the sales tax to some services. Highlight the economic and equity impacts of extending the tax to particular services, but not others. Prepare detailed recommendation.
Evaluate the efficiency and equity of the state income tax LEAD IMPLEMENTERS: Task Force, CMAP Board, State	Evaluate the impacts of graduating the state income tax by applying marginal rates for different tax brackets. Also evaluate the relatively narrow nature of the state's income tax base, given its exemptions for retirement income, particularly public and private pensions. Prepare detailed recommendation.
Evaluate the various ramifications of local tax capacity LEAD IMPLEMENTERS: Task Force, CMAP Board, State, counties, municipalities	Evaluate the overall equity impacts of the tax system in northeastern Illinois. Recommend tax and other fiscal reforms that promise to increase equity without sacrificing regional economic productivity. Prepare detailed recommendation.