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# State and Local Taxation

CMAP Regional Snapshot

Existing Conditions and Issues of  
Significance in Metropolitan Chicago



## About this Snapshot...

From a regional planning perspective, it is vital to understand the dynamics of various tax policies, especially in terms of their potential impacts on development decisions and regional economic productivity. Most, if not all, planning decisions have fiscal consequences, both direct and indirect. Today's metropolitan landscape is largely shaped by land use decisions made by local governments. In part, these decisions are motivated by local fiscal imperatives. As the regional agency responsible for producing a long range comprehensive plan, CMAP plays a valuable role by researching and analyzing ramifications of these local decisions as they play out across time and space.

This report describes a range of key issues related to state and local tax policies across the Chicago metropolitan region, with an emphasis on the property tax, sales tax, income tax and motor fuel tax. It also explains existing state and local revenue sharing arrangements and summarizes the available research on the relationship between taxation, business activity and land use decisions. The CMAP Board specifically directed CMAP staff to study these issues with the goal of readying recommendations for *GO TO 2040*.

This report does not contain specific recommendations and should not be viewed as suggestive of any particular policy. However, *GO TO 2040* is likely to discuss matters of public finance and also provide more direct recommendations about these matters. "Tax policy" is one of numerous key policy directions to be addressed in the comprehensive regional plan, which will be completed in October 2010.

See <http://www.cmap.illinois.gov/snapshot.aspx> for a more-detailed technical report on this topic.

## CMAP's Tax Principles

The following principles, adopted by the CMAP Board on May 6, 2009, are intended to help CMAP judge taxes and other revenue generators at the state and local levels. While not exhaustive in scope, these principles are a helpful starting point for understanding how to think about and analyze components of state and local taxation.

- **Short-term Adequacy and Long-term Sustainability**  
In the short term, revenues from taxes and fees should adequately provide for the programs and policies demanded by citizens. Furthermore, over the longer term the bundle of taxes and fees should generate stable and predictable revenues that rise at a level consistent with real changes in purchasing power.
- **Broad Tax Base with Low Tax Rates**  
Residents and businesses prefer low taxes, but also good schools and neighborhoods, quality infrastructure, and access to recreational and cultural opportunities. One strategy for keeping tax rates low while also providing for these critical services is to ensure that the tax base is as broad as possible. A broad tax base is one with few exemptions, deductions, and credits.
- **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.
- **Ease of Administration**  
A tax or fee that is difficult to collect typically leads to noncompliance. As complexity increases, so does tax avoidance, tax evasion, and the cost of monitoring.
- **Transparency and Accountability**  
State and local tax policy should strive to be as open and transparent as possible. It is vital for all taxpayers to have access to a full accounting of the types of revenues collected and the distribution of the revenue, as well as of the entities receiving exemptions or other tax benefits.

## State and Local Revenues, at a Glance

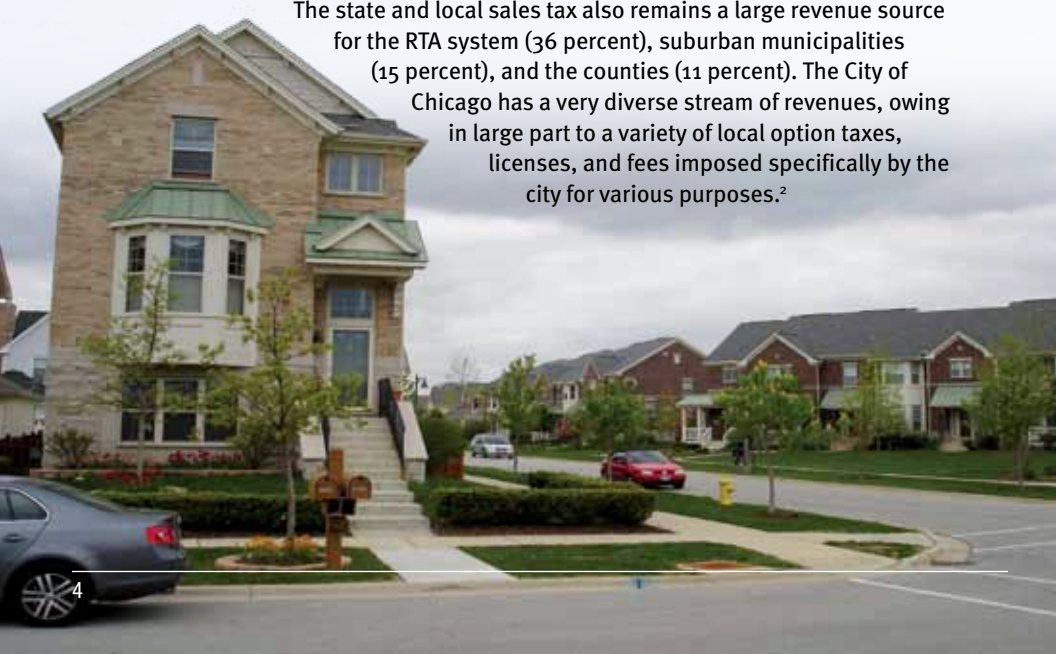
In the seven-county region of northeastern Illinois, 1,226 different units of government collect revenues and provide services to residents, businesses and visitors. No region in the U.S. has nearly as many units of government as metropolitan Chicago. By CMAP's calculations, units of local government in northeastern Illinois have received nearly \$40 billion in annual revenues in recent years.<sup>1</sup> The largest revenue source for local government is the property tax (30 percent). State intergovernmental revenues — including the state sales tax, income tax, motor fuel tax, and other disbursements and aid — make up 20 percent of the revenue. Charges and user fees make up about 15 percent of the total.

Units of Government in Northeastern Illinois	
Counties	7
Municipalities	284
Townships	123
School Districts	307
Fire Districts	136
Park Districts	173
Library Districts	108
All Other	88
<b>Total</b>	<b>1226</b>

Source: Illinois Department of Revenue

Revenue sources among these local governments vary considerably. The property tax makes up nearly 80 percent of township revenue, 73 percent of library, fire, and park district revenue, and 55 percent of school district revenue. It also remains a very important revenue source for counties (34 percent) and suburban municipalities (22 percent). Charges, user fees, and fares also make up a large and growing portion of the budgets for suburban municipalities (27 percent) and the counties (20 percent). Farebox revenue for the public transportation system makes up roughly 34 percent of the total revenues for the Regional Transportation Authority and service boards.

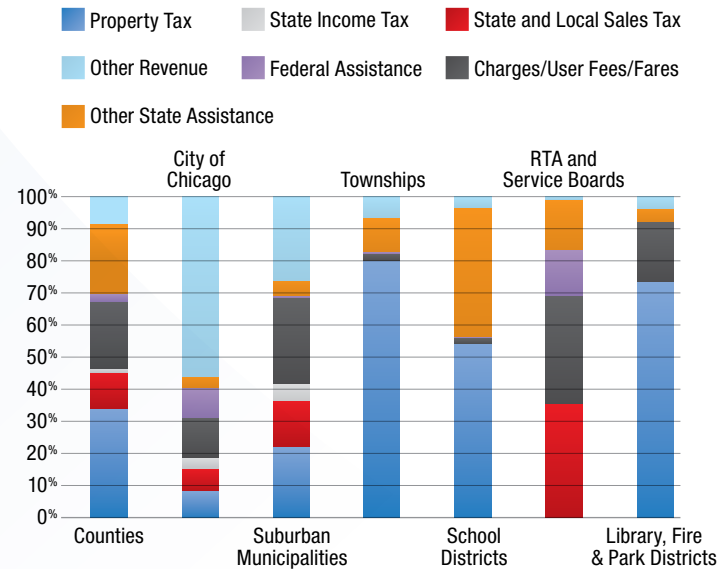
The state and local sales tax also remains a large revenue source for the RTA system (36 percent), suburban municipalities (15 percent), and the counties (11 percent). The City of Chicago has a very diverse stream of revenues, owing in large part to a variety of local option taxes, licenses, and fees imposed specifically by the city for various purposes.<sup>2</sup>



The region's 284 municipalities vary widely, both in terms of their relative reliance on revenue sources and also the services they provide. One striking variation is the reliance on state and local sales tax revenues, relative to the property tax.

The map on the following page shows the reliance on state and local sales tax revenues, relative to "derived" property tax levies, which include an estimate of municipal plus predominant park, fire, and library districts. Using "derived" levies helps to control for the differing municipal service provision characteristics across the region. While municipal governments often provide park, fire, and library services, oftentimes these services are provided by other local units of government. School districts, which rely heavily on property taxes, are not included in this analysis. The map represents a starting point for understanding the dynamics of reliance on sales tax, relative to property tax, for municipalities and other special districts across the region.

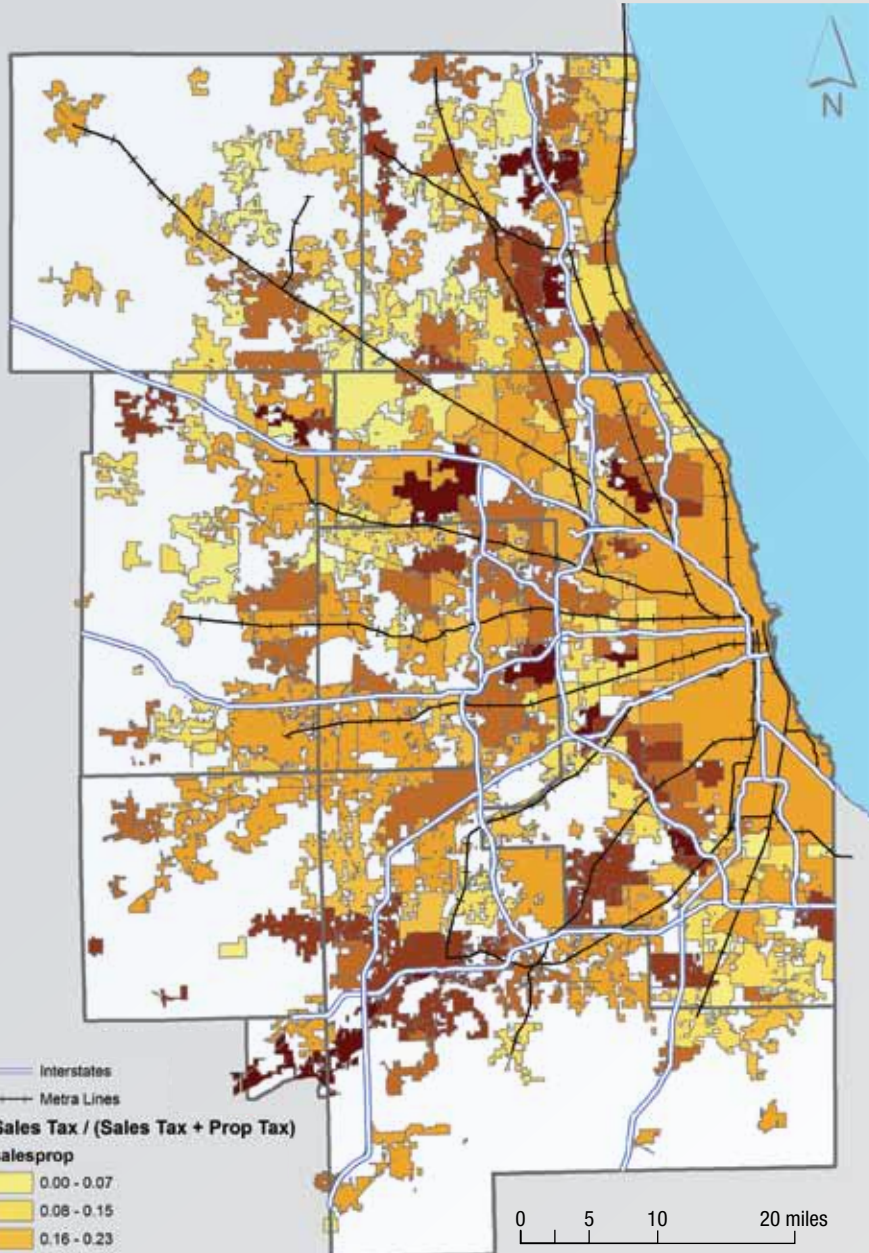
### Revenue by unit of government, Chicago metropolitan area



Sources: U.S. Census, Illinois Department of Revenue, Illinois Comptroller, Regional Transportation Authority "Moving Beyond Congestion" strategic plan. Numbers are for 2007, except for counties, school districts, and RTA (2006).



### Sales Tax Revenues Relative to Property Tax Revenues, 2007



CMAP 2009

Source: Illinois Department of Revenue and County Clerks Offices.

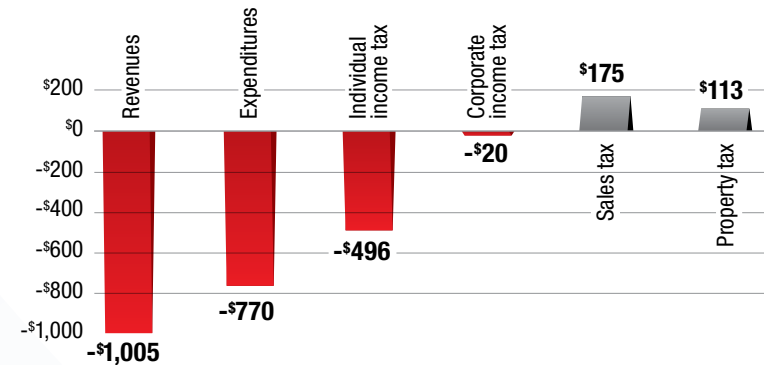
This map shows municipal state and local sales tax revenues (2007) divided by the sum of sales tax and derived property tax levies (2007). Derived property tax levies include municipal plus predominant park, library and fire districts. Darker shading indicates a higher reliance on sales tax, relative to property tax. Lighter shading indicates a higher reliance on property tax.

### Comparison with Other States

Overall, the State of Illinois and local governments here remain more reliant on property and sales taxes and less reliant on personal income taxes than other states. A comparison of tax revenues against ten neighboring and comparable states (Midwestern and Northeastern urban and industrial states: Minnesota, Wisconsin, Missouri, Michigan, Indiana, Ohio, Pennsylvania, New Jersey, New York, and Massachusetts) demonstrates that on a per capita basis, state and local governments in Illinois also generate fewer revenues and make fewer expenditures.

#### Illinois state and local revenues per capita, relative to ten other midwest and east coast states

(difference between Illinois and average of other states)



Source: Tax Foundation

The \$0 baseline is the average of other states selected for comparison. Other states are Indiana, Massachusetts, Michigan, Minnesota, Missouri, New York, New Jersey, Ohio, Pennsylvania and Wisconsin. All numbers are for 2006 except for tax revenues and expenditures, which are for 2008.

## State and Local Revenue Sharing

All local governments in northeastern Illinois are prohibited from imposing a local income tax without state legislative authorization, and many cannot impose local option sales taxes. But all counties and municipalities receive a share of both from the Illinois Department of Revenue via a monthly disbursement. Furthermore, other state-sourced tax collections such as the Motor Fuel Tax and Personal Property Replacement Tax return a share of the revenue back to some local governments based on various formulas. In 2007, municipalities in northeastern Illinois received roughly 20 percent of their revenues through state revenue sharing sources.<sup>3</sup> The following table briefly explains some of these state/local revenue sharing arrangements.

### Examples of State/Local Revenue Sharing Arrangements in the State of Illinois<sup>4</sup>

State Tax Source	How Imposed	Local Governments Receiving Disbursement	Disbursement Formula	Amount Disbursed to Local Governments in Northeastern Illinois (2008)
<b>Sales Tax</b>	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 <sup>5</sup>	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 <sup>6</sup>
<b>Personal Property Replacement Tax</b>	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 <sup>7</sup>	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
<b>Income Tax</b>	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
<b>Motor Fuel Tax</b>	\$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. <sup>8</sup>	\$377 million
<b>Telecommunications Tax</b>	Imposed by local ordinance or resolution in ¼ percent increments with a 6% maximum rate limit.	Municipalities	After taking a ½% 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

## Taxation and Business Attraction/Retention

How do tax policies impact state, regional, and local business activity? While conclusions vary, available research informs this question. Two of the main conclusions follow:

- *While state and local taxes do have an impact on business location decisions, the impacts appear to be relatively small relative to other factors.*

As firms seek to maximize profits, it follows that higher tax rates (which reduce business revenue) should negatively impact where businesses choose to locate. However, while that statement may be true “all else equal,” this assumption does not necessarily reflect the reality on the ground. Tax rates are only one of many characteristics driving these decisions. Other factors, including labor force quality, infrastructure, and the regulatory environment may assume more importance for businesses. Furthermore, taxes are usually linked to the provision of services and amenities. While it is true that extremely disadvantaged areas must often keep tax rates high simply to keep pace with service needs, in many cases increased tax revenue can result from higher quality public services. For example, a business may be willing to pay higher property taxes in one municipality if the result is higher quality policing, which in turn allows the business to forgo the hiring of private security.

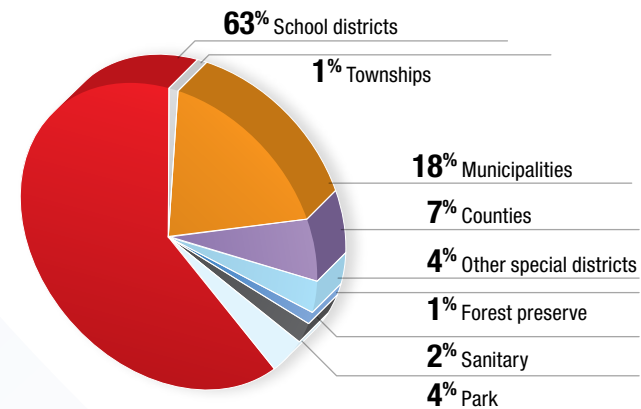
- *Tax differences appear to have a larger impact on business activity within metropolitan regions rather than across them.*

While the effect of taxes appears to be small relative to other factors, there is good evidence that taxes matter more within metropolitan areas rather than across them. While “state vs. state” or “region vs. region” tax differentials show only small impacts in terms of business attraction and retention, the “local vs. local” differentials show relatively larger impacts. These results exemplify the theory of the local government “marketplace,” where municipalities and counties compete with one another to attract and retain businesses to enhance local tax bases. This may set the stage for a competitive environment over development and tax revenues within the metropolitan area, and many businesses that can move relatively cheaply within the metropolitan region may do so in order to take advantage of these differentials.<sup>9</sup>

## Property Tax

Property tax revenue constitutes the largest source of funding for the counties, municipalities, school districts, and special districts in the Chicago metropolitan area. In Illinois, property tax rates are set by local governments and vary from place to place. Individual taxing bodies, such as counties, municipalities, townships, and school and park districts have their own rates that are individually determined by the relationship between their annual financial requests and the assessed value of property within their geographical boundaries.<sup>10</sup> Property tax rates in the Chicago metropolitan area vary widely. Generally speaking, rates can be understood as a function of service provision needs, the value of real property, and other revenue sources.

### 2006 Property tax extension by district, northeastern Illinois



Source: Illinois Department of Revenue

Total property tax “extensions” (taxes billed) in northeastern Illinois totaled \$17.5 billion in 2006. In 2008 constant dollars, property tax revenues have been on the rise in recent years, increasing from roughly \$15 billion in 2000 to over \$18 billion in 2006. The distribution of property tax revenues, shown in the chart above, skews heavily toward the region’s 300+ school districts. In 2006 school districts received 63 percent of the total extensions in northeastern Illinois. Municipalities received 18 percent, counties received 7 percent, and park districts collected 4 percent. Sanitary districts, forest preserves, and other special districts received a combined 7 percent of the extensions.<sup>11</sup>





## Policy Implications of the Property Tax

As the major source of revenue for local governments in northeastern Illinois and across the U.S., the property tax has been studied extensively. Economists tend to agree that, assuming a well-designed system, the property tax is the most effective and efficient means of raising local revenues. 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).<sup>12</sup> However, the property tax system in northeastern Illinois can also be quite complex, and at times tax burdens across different communities or types of properties are extremely difficult to predict. Some major issues regarding the property tax include the following:

### ■ *Property Tax Extension Limitation Law (PTELL)*

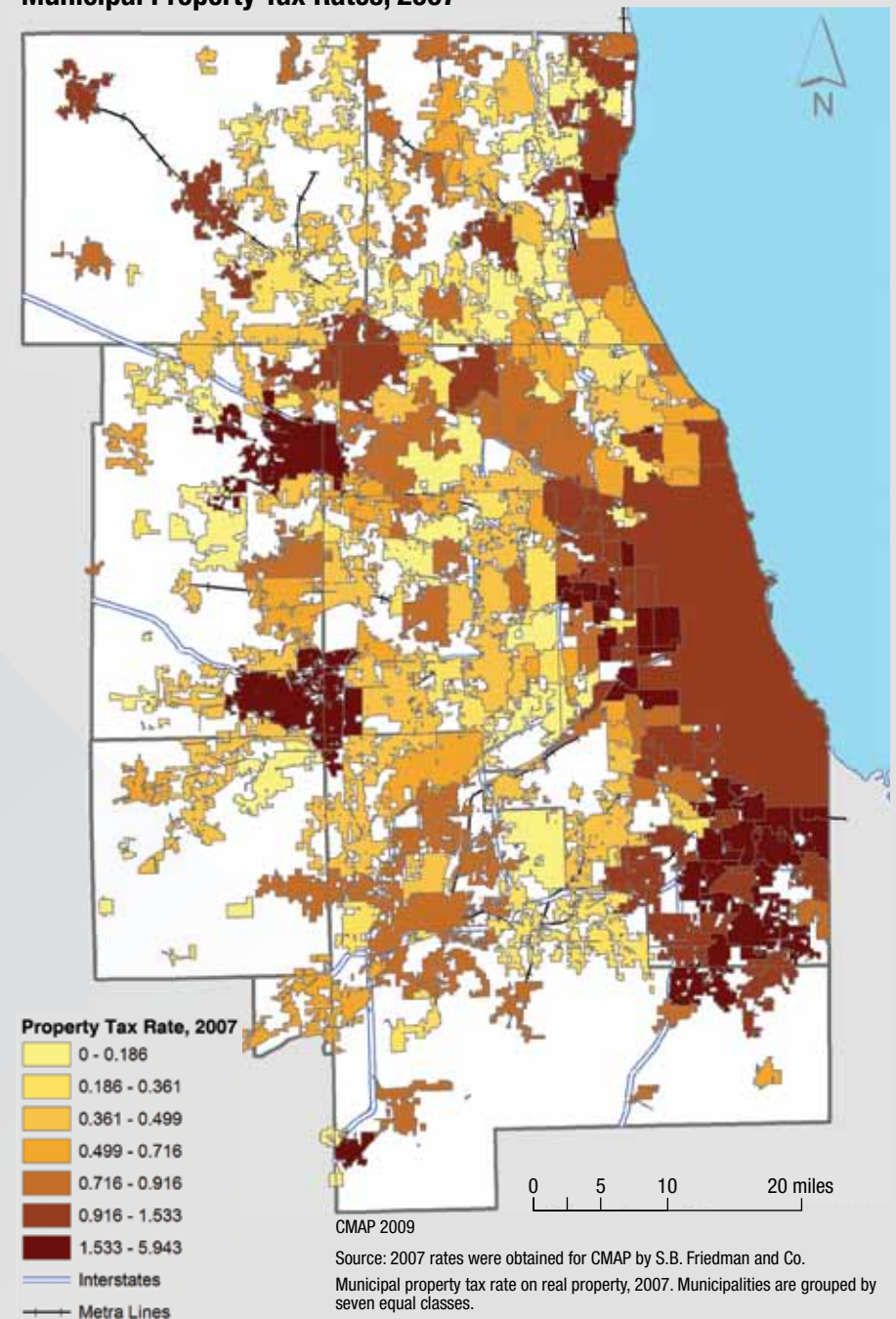
Increases in property taxes to non-home rule governments are limited by the State of Illinois under the Property Tax Extension Limitation Law (PTELL), passed in the early 1990's. PTELL is currently in effect for all northeastern Illinois counties. The law was designed to limit property tax extensions (i.e., total taxes billed) in areas with rapidly increasing property values, namely locations in which property values were increasing faster than inflation. The law does allow for inflationary increases, which are limited to the lesser of 5 percent or the increase in the Consumer Price Index.<sup>13</sup> Recent research indicates that PTELL does indeed limit growth in property tax bills for both municipalities and school districts. Additionally, these results appear to grow stronger over time.<sup>14</sup>

PTELL is an important policy issue because the tax cap serves to constrain some local government 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. In 2009, local governments under PTELL could barely raise extensions at all, given the zero growth in the consumer price index over the last year (PTELL constrains revenue increases based in part on the CPI). While certainly more extreme than Illinois, the California experience with tax caps under Proposition 13 has led to increased state control over education as well as a greater reliance on zoning and incentives to capture sales tax revenues.<sup>15</sup>

### ■ *Classification*

County governments are authorized to assess properties in Illinois. The collar counties assess all properties, regardless of type, at 33 1/3 percent of market value (except for agricultural land). Cook County law, on the other hand, stipulates the assessment of residential properties at 10 percent and commercial properties at 25 percent. While the ramifications of this arrangement are complex, the main impact is to shift the property tax burden away from residents and toward businesses in Cook. Furthermore, there is good evidence that property tax differentials within metropolitan regions have a significant impact on local business location decisions. With a higher burden placed upon businesses in Cook County due to classification (as well as high sales tax rates), this may have the effect of shifting economic activity out of Cook County in a distortive, rather than a market-driven, fashion.<sup>16</sup>

## Municipal Property Tax Rates, 2007



## Examples of Property Tax Limitations, Classification and Exemptions in Northeastern Illinois

Program	Where Imposed or Eligible	Description	Possible Impacts
<b>Property Tax Extension Limitation Law (PTELL)</b>	Non-Home Rule Governments	Limits growth in levies (total taxes billed) to 5% or increase in the Consumer Price Index, whichever is less. New properties and developments are exempt. Voters can approve an increase in tax rates above PTELL via four referenda options.	Limits the ability for some local governments to raise property tax revenues beyond a certain level. May shift reliance to other taxes or fees. Since property tax revenues to these governments are limited, this may impact the quality of services.
<b>Classification</b>	Properties in Cook County	In Cook County, residential properties are assessed at 10% and commercial/industrial properties are assessed at 25%. This differs from other counties in northeast Illinois, which assess all properties at 33%. Classification does not lower total taxes billed in communities where it is imposed, but it does shift the tax burden to, and away from, different classes of properties.	All else equal, classification increases business' share of equalized assessed value, hence the share of any given property tax burden.
<b>7% Expanded Homeowner Exemption</b>	Owner Occupied Residential Properties in Cook County	Passed in 2004, the law limited the increase in a homeowner's equalized assessed valuation to 7% a year. The law also capped the amount of the exemption at \$20,000. The law is currently being phased out over the next several years, with the exemption cap first raised to \$40,000 and then lowered to \$26,000, \$20,000, and \$6,000.	When imposed, the exemption may have shifted the property tax burden from eligible property owners to ineligible property owners. However, the recent phase out of the exemption may have the effect of shifting property tax burden back to eligible property owners.

### ■ 7 Percent Expanded Homeowner Exemption

Another issue that adds increased complexity to the property tax in northeastern Illinois is the 7 Percent Expanded Homeowner Exemption, which has been eligible to owner occupied residential properties in Cook County. In 2004, the Cook County Board enacted the so-called "7 percent cap," which, like PTELL, was designed to protect residential property owners from a large jump in property tax bills due to rapid appreciation in an area. The cap originally limited the growth in taxable value of a property to 7 percent per year, up to a \$20,000 maximum exemption. Assuming that tax levy requests remain constant, the "7 percent cap" essentially shifts the tax burden from homeowners with exemptions to other property owners in the county. However, this tax break is currently being phased out, and there is recent evidence that the tax burden has shifted back to residential homeowners.<sup>17</sup>

### ■ School Funding

Reliance on the property tax for financing education is certainly related to large inequalities among school districts in terms of per pupil spending. For instance, while the national average shows a difference of \$825 in per pupil spending between high and low poverty districts, the gap in Illinois is \$1,924.<sup>18</sup> While expenditure data is not sufficient for explaining gaps in school and student performance, reliance on the property tax does cause funding inequalities based purely on the differing assessed property values among districts. School districts in Illinois have been demonstrated to be more dependent on the property tax than those in other states. In fact, only Nevada relies more on the property tax for school funding.<sup>19</sup> This situation may promote funding disparities between areas with high property values and low property values, and may incent local governments to pursue land uses with higher property values.





## Sales Tax

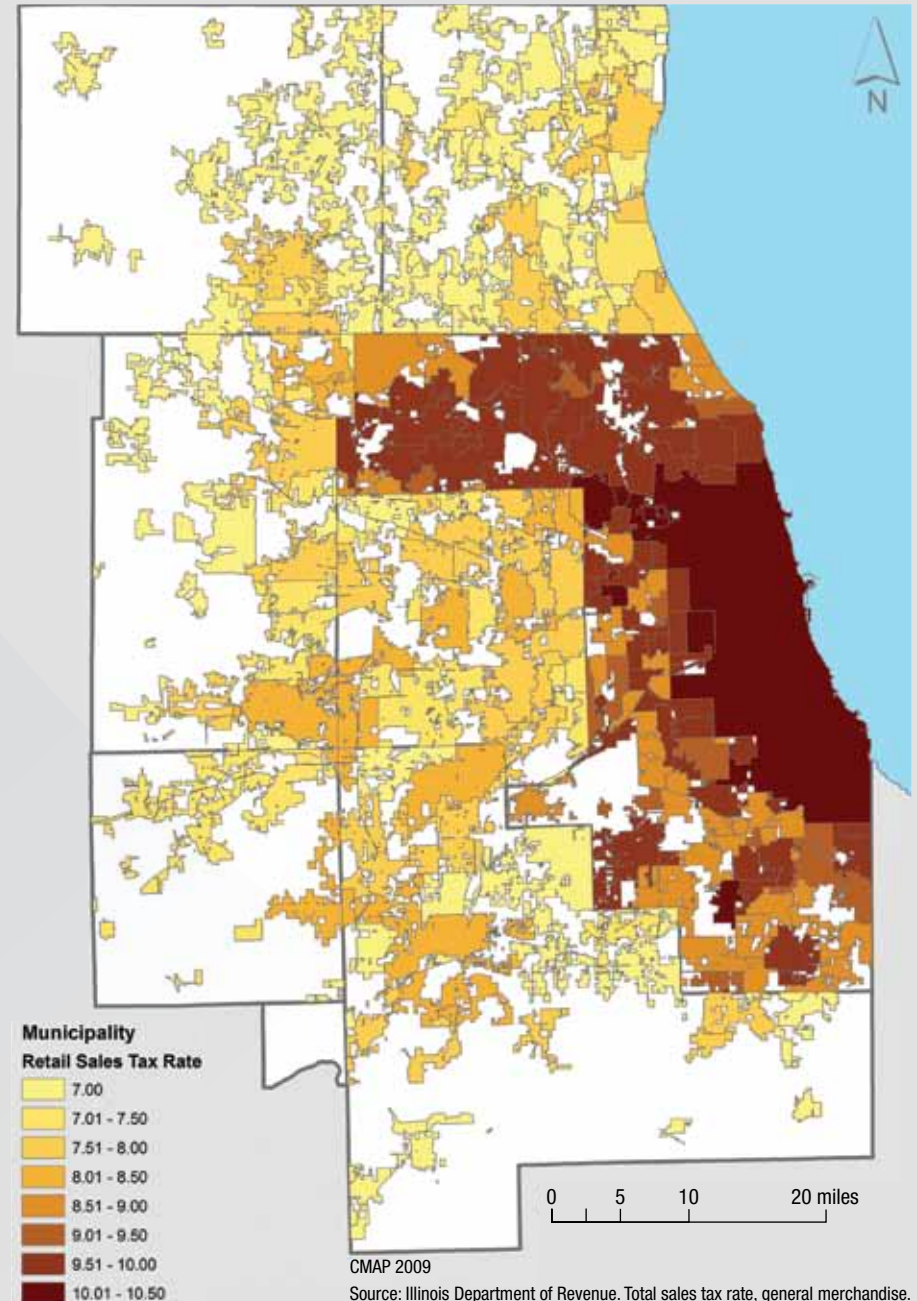
The various sales taxes imposed across the state raise considerable revenue for the State of Illinois, counties, municipalities, and special districts. In FY 2008, the State of Illinois collected just over one-third of its revenue from the sales tax.<sup>20</sup> The state currently levies the sales tax at a base rate of 6.25 percent on general merchandise and titled or registered items, and 1 percent on qualifying food, drugs, and medical appliances.

Of the total revenue collected on general merchandise, titled and registered items (the 6.25 percent rate), the state retains 80 percent of the collections for its own uses and distributes the remaining 20 percent to local governments (16 percent to municipalities, 4 percent to counties), based on point-of-sale.<sup>21</sup> The Cook County portion of this disbursement is allocated to the Regional Transportation Authority, rather than to the county. Of the total revenue collected on qualifying food, drugs, and medical appliances (the 1 percent rate), 100 percent is returned to the municipality.

Local sales taxes are also imposed by Cook and Kendall counties, some municipalities, the RTA, and the DuPage County Water Commission. The result is a wide variation in sales tax rates faced by consumers across the CMAP region. Rates range from 7 percent in many non-home rule collar county municipalities to over 10 percent in some Cook County municipalities.<sup>22</sup> Rates have experienced some recent flux, particularly in Cook County, which just voted in December 2009 to lower the county rate from 1.75 percent to 1.25 percent. These changes will take effect in July 2010.



## Sales Tax Rate by Municipality as of November 2009

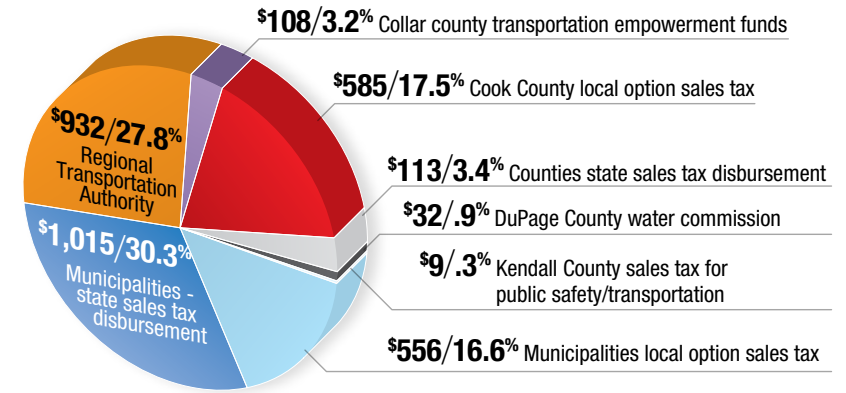


Source: Illinois Department of Revenue. Total sales tax rate, general merchandise. New rates in Cook county will take effect in July 2010.

### Sales Tax in Northeastern Illinois: Rates and Allocations

Sales Tax	Base Tax Rate	Allocation of Revenues
Retail Sales of General Merchandise, Titled or Registered Items, and Qualifying Food, Drugs, Medical Appliances	6.25%	All revenues are collected by the State and then allocated according to the following formula: 5% state portion (equivalent to 80% of tax collections), 1% municipal portion (equivalent to 16% of tax collections), 0.25% county portion (equivalent to 4% of tax collections). In Cook County, the 0.25% county portion is allocated to the RTA.
Sales of Qualifying Food, Drugs, Medical Appliances	1%	1% (equivalent to 100% of tax collections) is collected by the State and returned to the municipality.
County Option Sales Tax <sup>23</sup>	1.75% in Cook County, 1% in Kendall County.	100% of tax collections are collected by the State and returned to Cook County. The Kendall County local option tax is used for transportation and public safety.
Municipal Home-Rule/ Non-Home Rule Local Option Sales Tax	Rates apply to general merchandise and vary widely across the region.	100% of tax collections are collected by the State and returned to the municipality.
RTA Sales Tax	In Cook County: 1% on general merchandise and titled/ registered items, and 1.25% on food, drugs and medical appliances. In DuPage, Kane, Lake, McHenry, and Will: 0.75% on general merchandise, titled or registered items, and qualifying food, drugs and medical appliances.	Cook County portion: 100% of tax collections are collected by the State and disbursed to the RTA. Collar county portion: 0.50% (equivalent to two-thirds of tax collections) is collected by the State and disbursed to the RTA. 0.25% (equivalent to one-third of tax collection) is collected by the State and disbursed to the county governments. These funds are known as "Collar County Transportation Empowerment Funds."
DuPage County Water Commission	0.25% above and beyond state and local rates on general merchandise and titled and registered items in unincorporated DuPage County and municipalities served by the district.	100% of tax collections are collected by the State and returned to the DCWC.

### Sales tax disbursements to northeastern Illinois, State FY 2009, in millions of dollars



Source: Illinois Department of Revenue

Over the last seven years, total sales tax revenues retained by local governments in northeastern Illinois have risen. In 2009, local governments, including the RTA, received over \$3 billion in sales tax, representing an over \$500 million dollar increase from 2003 (in 2008 constant dollars). However, it is important to note that this rise has been driven primarily by recent rate increases to county local option sales tax rates and to the RTA sales tax. Municipal and county disbursements from the State have actually fallen in constant dollars between the years 2003 and 2009.





## Policy Implications of the Sales Tax

### ■ *Regressivity*

Despite its application in all but five of the 50 states, the sales tax has been criticized as being regressive, i.e., that it disproportionately affects the poor. According to the Institute on Taxation and Economic Policy (ITEP), the poorest quintile of Illinois residents paid just under 12 percent of their income in state and local taxes in 2007; nearly 7 percent of these residents' incomes were paid in sales tax alone. On the other hand, the top 1 percent of Illinois residents paid just under 5 percent of their incomes in state and local taxes during the same period, with sales taxes claiming less than 1 percent.<sup>24</sup> The fact that tangible goods are taxed but services are not further exacerbates the sales tax's unequal impact; the poor are less likely to buy services compared to the wealthy.

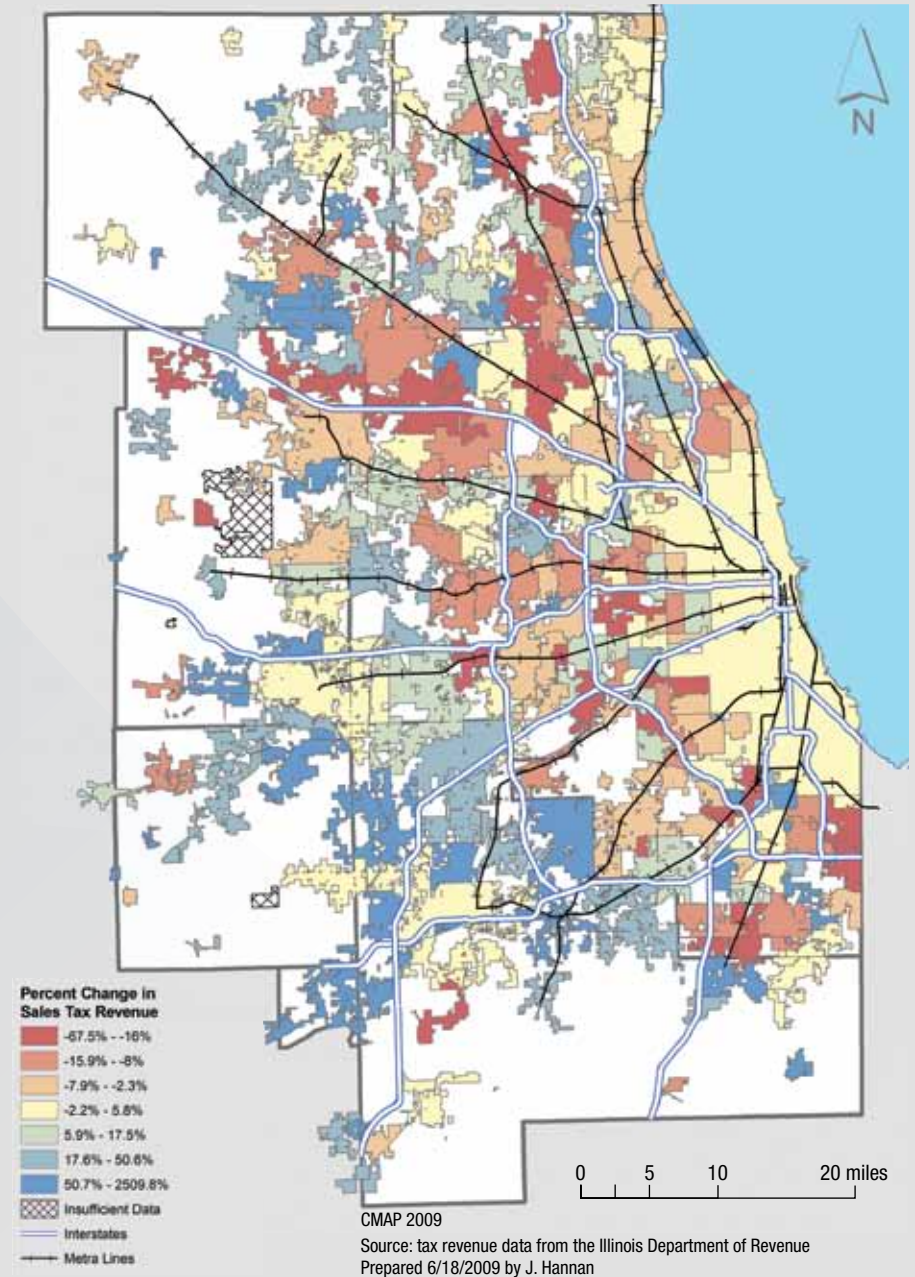
### ■ *Taxing Services*

One potential way to raise revenue and also limit the regressive nature of the sales tax is to widen the tax base to include the service sector. Extending the tax to services could potentially capture value from a large and growing portion of the regional economy. Currently, Illinois taxes only 17 services, which ranks 46th in the nation. Only Oregon, Alaska, New Hampshire, and Colorado tax fewer services; the first three are among the five states that do not collect a state sales tax (the other two are Delaware and Montana). In comparison, Hawaii collects tax on 160 services, and New Mexico, Washington, South Dakota, Delaware, and West Virginia all collect tax on more than 100.<sup>25</sup> Services, unlike goods, are consumed disproportionately by wealthier taxpayers. Thus, taxing services can help to reduce problems of vertical and horizontal equity that result from the regressive nature of the tax.<sup>26</sup>

### ■ *"Fiscalization of Land Use"*

The reliance of municipalities on sales tax revenue may have particularly important implications for local development decisions. Recent research has proposed several important policy questions related to this issue. The efforts of multiple communities to capture the fiscal benefits of new retail developments may over-emphasize this land use relative to others in an attempt to capture retail spending dollars. These development policies may produce a net regional fiscal cost if incentive outlays are used to attract the business from one community in the region to another. Furthermore, there is evidence that a heavy reliance on sales tax revenues may not be sustainable over time, given fluctuations in the economy that greatly impact retail sales.

## 2003-2008 Percent Change in Municipal Share of State Sales Tax Revenue for CMAP Municipalities in 2008 Dollars



## State Income Tax

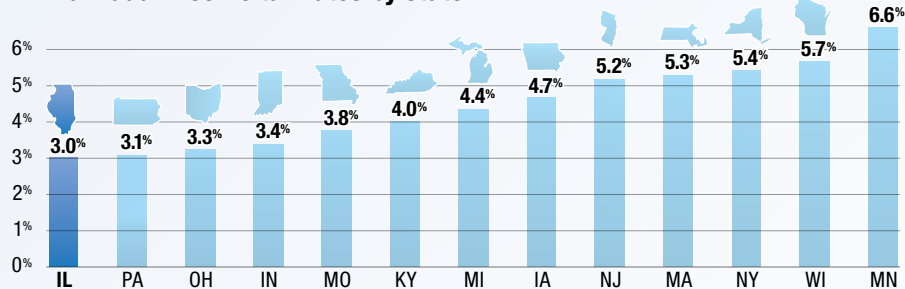
The Illinois Constitution allows for a fixed rate, or “flat,” tax on personal and corporate incomes. Different flat rates are assigned to corporations, individuals, and trusts and estates. The rate levied on corporations is not to exceed that levied on individuals according to an 8 to 5 ratio. For individuals, the rate is 3 percent of net income. The rate for corporations is 4.8 percent, and the rate for trusts and estates is 3 percent. The gross income tax is collected by the Illinois Department of Revenue and deposited by formula into four separate funds. One tenth of the General Revenue Fund collection is then disbursed to counties and municipalities, based on population. In FY 2008, \$1.2 billion in income tax revenue was disbursed to counties and municipalities. Local governments in northeastern Illinois received about 60 percent of this amount, or roughly \$713 billion in revenue.

### Policy Implications of the State Income Tax

#### ■ Low Rate, Relative to Other States

The State of Illinois has one of the lowest individual (3 percent) and corporate (4.8 percent) income tax rates in the U.S. The chart below shows Illinois’ flat individual rate compared to neighboring midwestern states as well as other eastern, industrialized states with urban centers (Pennsylvania, New York, New Jersey and Massachusetts).

#### Individual income tax rates by state



Source: The Tax Foundation

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.

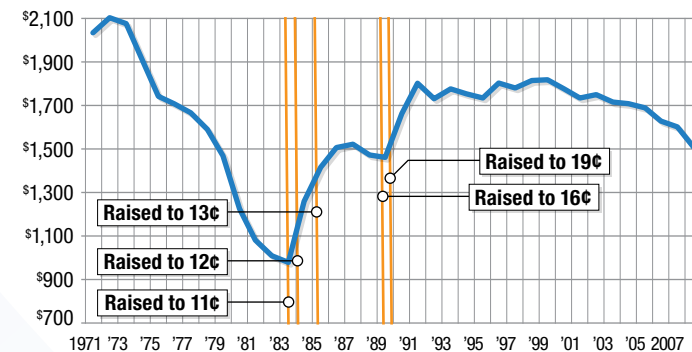
#### ■ Flat Nature of the Tax

While slightly progressive when exemptions and deductions are accounted for, the State of Illinois income tax remains one of if not the least fair income taxes in the U.S. According to the Institute on Taxation and Economic Policy, low-income residents in Illinois still pay more (and high-income residents pay less) of their income in state income tax than residents from all other states with an income tax.<sup>27</sup> The main reason is that few states use a flat rate like the one in Illinois. Most opt instead for a graduated system. In fact, of the 40 states that collect income taxes, Illinois is one of only seven that charge a flat rate, as opposed to a graduated system. A graduated system could expand tax capacity with marginal rates for different brackets based on ability to pay. Graduated taxes are typically considered to be progressive in nature and thus more equitable, although the increased complexity of the tax complicates its administration.

## State Motor Fuel Tax

The Motor Fuel Tax (MFT) raises considerable revenue for both the State of Illinois and local governments, and the distribution of these revenues is the primary state-generated source of funding for road maintenance and construction. In inflation-adjusted dollars, the MFT has declined since the early 1990’s. After a variety of deductions, 45.6 percent of the revenues is allocated to the Illinois Department of Transportation’s Road Fund and State Construction Fund, and the remaining 54.4 percent is allocated to local governments.<sup>28</sup> In 2008, roughly \$200M was deducted off the top for various programs and funds, while \$341M was distributed to the IDOT Road Fund, \$200M to the IDOT Construction Fund, and nearly \$600M to local governments.

### Gross motor fuel tax revenues, state of Illinois, 1971-2008, in millions of 2008 dollars



Source: Chicago Metropolitan Agency for Planning and the Illinois Department of Transportation

### Policy Implications of the State Motor Fuel Tax

#### ■ Revenues Not Keeping Pace with Inflation

It is likely that a large untapped revenue capacity exists in the State MFT, based on the fact that the 19-cent per gallon rate has not been raised since 1990. Inflation-adjusted revenues from the State MFT have declined since 1991 at a median annual rate of nearly 1.5 percent. Additionally, 31 states levy a higher per gallon tax rate than Illinois.<sup>29</sup> It is important to note that the decline in these funds occurs against a backdrop of increasing deferred maintenance needs for the State and local governments, due primarily to the increased costs to maintain or reconstruct roads and bridges. While these MFT allocations have decreased close to 30 percent (in real terms) between the years 1996 and 2008, maintenance costs on local roads have grown steadily over this time.<sup>30</sup> The result is a tremendous drop in MFT purchasing power for local governments that seek to maintain their roads in a state of good repair.



## Taxation and Land Use

While local governments in the Chicago metropolitan region rely on a variety of different taxes for some portion of their municipal revenue, the most prevalent sources are the sales and property tax. Reliance on (or the drive for) one or both of the revenue sources may have regional land use implications. The local fiscal imperative may be to orient land use planning and decision making to maximize these revenue streams.

Orienting land use decisions to maximize municipal revenue streams became widely recognized as an issue in California following the adoption of Proposition 13 (which limited property tax increases). This behavior has been dubbed the “fiscalization of land use,” which can be defined as a local land-use decision process whereby municipalities choose retail and other industries that generate local tax revenues, rather than industrial or office uses that generate jobs. High tax-generating uses such as big-box retail and auto dealerships tend to create more dispersed land use patterns, as demonstrated by their low floor area ratio (FAR), higher reliance on surface parking, and automobile orientation. This creates a conflict between local decisions to maintain fiscal balance and the regional economic goal to preserve and create full-time jobs, generate compact land use patterns, and further an efficient urban transportation framework.

S. B. Friedman & Company was engaged by CMAP to quantify the municipal fiscal benefits and regional economic benefits for four different land uses in order to demonstrate these conflicts using data and metrics specific to the Chicago region. The land uses investigated were auto dealership, retail power center, corporate office, and light industrial. The selection of land uses were such that each would result in large-scale development with significant development impacts, providing an opportunity to highlight the fiscal and economic disparities associated with current tax policies. The analysis also focuses on suburban Chicago, where greenfield land is more readily available for such large-scale developments and where such development is occurring at a relatively rapid pace.

The results, shown in the following table, indicate a significant difference between the “high-sales-tax-generating” retail and auto uses versus the office and industrial uses. 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 several orders of magnitude less output than the office and industrial options. These results highlight the potential for disparity between local land use decisions and regional planning for jobs and industry.

## Fiscal and economic impact comparison by acre

	Retail Power Center	Auto Dealership	Corporate Office	Industrial
<b>Fiscal Impacts</b>				
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
<b>Direct Economic Impacts</b>				
Direct FTE Jobs/Acre	16	7	61	11
Direct Wages/Acre	\$573,100	\$452,900	\$6,873,700	\$814,000
<b>Indirect Economic Impacts</b>				
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.

## Next Steps

While this report provides an overview of the region’s state and local tax system and relevant policy issues, it does not make specific recommendations for action. It is designed to inform CMAP’s approach to the *GO TO 2040* plan, which will make such recommendations. CMAP will continue to engage in a variety of data collection and analysis efforts related to state and local taxation. Some of these continuing efforts are as follows:

- Regression analyses to estimate the main taxation and socioeconomic drivers behind retail land uses, property tax rates, and other dependent variables.
- Continued research and analysis on both “horizontal” and “vertical” tax competition. “Horizontal” tax competition refers to competitive efforts among the same units of government (i.e. municipalities) over tax revenues. “Vertical” tax competition refers to competitive efforts among different units of government (i.e., counties and municipalities).
- Continued research and analysis on the fiscal health of the State of Illinois and local governments, including potential opportunities for revenue generation and cost efficiencies. Research may include the State’s exemption of retirement income from taxation, as well as potential cost efficiencies from shared or consolidated local services.
- Outreach efforts to county and municipal governments to gain a better understanding of local issues and concerns related to state and local taxation.

## Endnotes

- 1 Analysis is based on data from the Illinois Comptroller, Illinois Department of Revenue, and U.S. Census Bureau from the years 2005-2008.
- 2 RTA figures are from Regional Transportation Authority. February 8, 2007. *Moving Beyond Congestion*.
- 3 Analysis of 2007 Illinois Comptroller data by CMAP.
- 4 Information and language directly from the IL Dept. of Revenue was used for this table.
- 5 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.
- 6 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.
- 7 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>
- 8 Eligible uses can be found in <http://www.dot.state.il.us/blr/mftbooklet.pdf>
- 9 See Wasylenko, Michael. March/April 1997. Taxation and Economic Development: The State of the Economic Literature. New England Economic Review, Proceedings of a Symposium on the Effects of State and Local Policies on Economic Development. and Fisher, Ronald. 2007. *State and Local Public Finance, Third Edition*. Mason, OH: Thomson Higher Education, pp. 659-664 for overviews of the literature regarding taxation and business activity.
- 10 Tax rates are generally determined according to a simple formula: Tax Levy/EAV = Tax Rate. "Tax Levy" refers to the funds requested by taxing bodies and "EAV" refers to the equalized assessed value of all properties within a taxing district. In northeastern Illinois, properties are initially assessed by the County Assessor. The resulting market value is then converted to an assessed value by applying assessment ratios (generally 33 1/3 percent for all properties except in Cook, which has different levels of property classifications). All else equal, a higher assessment level results in a higher tax rate. Equalization multipliers, calculated by the Illinois Dept of Revenue, help ensure that localities assess their properties fairly and uniformly. Local government units set their own tax levies and the County Clerk is responsible for "backing out" the tax rate (also called an "extension") for each jurisdiction.
- 11 Data from Illinois Department of Revenue.
- 12 See Brunori, David. 2003. *Local Tax Policy: A Federalist Perspective*. Washington D.C.: Urban Institute Press for a detailed overview of the logic of the property tax. The Lincoln Land Institute is also a good source of information regarding the property tax.
- 13 The rate for the 2009 extensions is 0.1 percent, Illinois Department of Revenue, 1/20/2009.
- 14 Dye, R. F., T. J. McGuire, and D. P. McMillen, 2005. Are property tax limitations more binding over time? *National Tax Journal* (58) 215-225.
- 15 Chapman, J. I., 1998. Proposition 13: Some Unintended Consequences. *Public Policy Institute of California*.
- 16 See the Civic Federation. April 10, 2008. *State of Illinois Constitutional Convention Fiscal Issues*. [http://civicfed.org/sites/default/files/civicfed\\_271.pdf](http://civicfed.org/sites/default/files/civicfed_271.pdf)
- 17 See the Civic Federation. March 26, 2007. *Effects of the 7 Percent Cap on Property Tax Paid in Cook County: 2002-2008*. <http://civicfed.org/civic-federation/publications/effects-7-cap-property-tax-paid-cook-county-2002-2008-including-project>
- 18 The Education Trust. Funding Gaps 2006. <http://www2.edtrust.org/NR/rdonlyres/CDEF9403-5A75-437E-93FF-EBF1174181FB/0/FundingGap2006.pdf>
- 19 Center for Tax and Budget Accountability. November 2007. Illinois Property Taxes: Issue Brief.
- 20 Illinois Department of Revenue, Annual Report of Collections and Distributions, 2008. Numbers do not include federal intergovernmental revenue and some other program revenues related to charges and user fees.
- 21 In unincorporated areas, the county government receives the disbursement that "would have gone" to a municipality.
- 22 Illinois Department of Revenue, "Illinois Tax Rate Finder," <https://www.revenue.state.il.us/app/trii/>.
- 23 DuPage, Kane, and McHenry Counties also impose a sales tax on motor fuel. The Cook county rate was lowered to 1.25 percent in December 2009. This change will take effect in July 2010.
- 24 Institute on Taxation and Economic Policy (ITEP). May 2009. *Ready, Set Reform: How the Income Tax Can Help Make the Illinois Tax System Fairer and More Sustainable*
- 25 Federation of Tax Administrators, "FTA Survey of Services Taxation - Update," July 2008, <http://www.taxadmin.org/fta/pub/services/btn/0708.html>
- 26 Institute on Taxation and Economic Policy. "Should Sales Taxes Apply to Services?," Policy Brief #3, 2008.
- 27 Institute on Taxation and Economic Policy (ITEP). May 2009. *Ready, Set Reform: How the Income Tax Can Help Make the Illinois Tax System Fairer and More Sustainable*
- 28 Illinois Department of Transportation. Bureau of Local Roads and Streets Manual. January 2006. Chapter 4: "Local Roads and Streets Funding."
- 29 Federation of Tax Administrators, "Motor Fuel Excise Tax Rates," January 1, 2008. [http://www.taxadmin.org/fta/rate/motor\\_fl.html](http://www.taxadmin.org/fta/rate/motor_fl.html)
- 30 Parsons Brinckerhoff, Economic Forecasting Review. Volume 3, Issue 1. May 2009. Since 2001 especially, the construction cost index has outpaced the consumer price index.





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