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GOOD FOR BUSINESS:

HOW ILLINOIS CAN BEST SUPPORT SMALL BUSINESS

April 7, 2014

Good for Business: How Illinois Can Best Support Small Business Research Team:

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ACKNOWLEDGEMENTS

The Center for Tax and Budget Accountability sincerely thanks the following (listed in alphabetical order) for their time, knowledge and expertise in peer reviewing this report:

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About CTBA

Founded in 2000, the Center for Tax and Budget Accountability is a non-profit, bi-partisan research and advocacy think tank committed to ensuring that tax, spending and economic policies are fair and just, and promote opportunities for everyone, regardless of economic or social status.

CTBA uses a data-focused, bipartisan approach to work in partnership with legislators, community groups and other organizations to help change both public policy and perceptions.

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ARRA	American Recovery and Reinvestment Act
BLS	Bureau of Labor Statistics
CBO	Congressional Budget Office
C-CORP	C-Corporation
COGFA	Commission on Government Forecasting and Accountability
CEPR	Center for Economic and Policy Research
CBPP	Center on Budget and Policy Priorities
CPI	Consumer Price Index
DCEO	Department of Commerce and Economic Opportunity
EARN	Economic Analysis and Research Network
ECI	Employment Cost Index
EFAB	Education Funding Advisory Board
FY	Fiscal Year
GDP	Gross Domestic Product
GOMB	Governor's Office of Management and Budget
IDOR	Illinois Department of Revenue
LLC	Limited Liability Company
ITEP	Institute on Taxation and Economic Policy
PA	Public Act
PPRT	Personal Property Replacement Tax
SBA	Small Business Administration
S-CORP	S-Corporation
TABSA	Taxpayer Accountability and Budget Stabilization Act

1. INTRODUCTION.

Given the sluggish job growth during the recovery that has followed the Great Recession,[1] decision makers both nationally and here in Illinois have indicated an interest in pursuing policy initiatives that will help spur the economy. Many have identified supporting small businesses and entrepreneurship as key to this effort. While various regulatory, spending and other policies (e.g. grants, technical assistance, incubators, and technology transfers) can directly and/or indirectly impact small businesses, the primary policy tools available fall into two distinct categories. On the one hand, policymakers can opt to reduce business and/or individual taxes in the hope that the tax relief will incentivize hiring and business expansion. Indeed, the Speaker of the House recently introduced a bill to reduce the state's corporate income tax to stimulate job growth.[2]

On the other hand, policymakers can make adequate investments in core public services and goods that businesses need to thrive, like education and infrastructure. Of the two primary policy tools available, the evidence overwhelmingly indicates that the latter approach is the best choice for supporting small businesses.

Knowing that the evidence shows business tax relief is not the best approach to stimulating the economy is one thing. What is crucial is that policymakers actually use this knowledge to craft effective, long-term solutions to one of the most challenging problems facing Illinois today—effectively stimulating the economy while dealing with the state's fiscal shortcomings. After all, the state has an accumulated deficit of at least $7.6 billion in its General Fund budget for FY2014, the current fiscal year.[3] This accumulated deficit is a very real problem that constrains the state's ability to make the very investments in education and infrastructure that are so crucial to small businesses.

2. KEY FINDINGS.

- It is legitimate for state government to pursue policies that support small business, given how important small businesses are to both the state's economy and labor markets.
    - According to the Small Business Administration, in 2011, fully 99.9 percent of all businesses nationally and 99.6 percent of the businesses in Illinois qualified as "small businesses," meaning they employed fewer than 500 workers.[4]
    - Truly small businesses, those "mom and pop" shops with 20 or fewer employees, make up the vast majority of small business in Illinois, representing roughly 97 percent of all businesses in the state.
    - In 2011, those truly small "mom and pop" businesses in Illinois employed 836,750 workers or 16.6 percent of all private-sector workers in the state.[5]
- Implementing business tax cuts is not the best way for Illinois state government to support small businesses specifically or economic growth generally. Indeed, while business taxes play a role in explaining differences in economic activity among states, that "effect is fairly small and easily outweighed by other factors."[6]
    - Research conducted across a broad ideological spectrum confirms that there is no statistically meaningful relationship between state tax policy on the one hand and small business/entrepreneurial activity on the other.[7]
    - In fact, according to researchers Noah Berger and Peter Fisher at the Economic Analysis and Research Network, simply cutting business taxes and paying for those tax cuts with service cuts has been both "inefficient and ineffective at stimulating growth in the long haul."[8]
    - The Harry S. Truman Institute at the University of Missouri found that when the economic benefits a business tax break may generate are netted against the economic costs stemming from concomitant cuts to state spending on services—there is a net loss in economic activity.[9]

- The reasons business tax cuts are not particularly effective at stimulating small business growth, hiring or the economy are easy to understand.
    - State income taxes constitute a relatively minor portion of overall business tax burden to begin with, representing just 8 percent of the taxes businesses pay in Illinois,[10] and a particularly immaterial burden for most small businesses which are formed as "pass-through" entities (i.e., S-Corporations, partnerships, Limited Liability Companies or sole proprietorships),[11] which by law are exempt from paying the corporate income tax assessed by Illinois and most of the 43 other states that assess corporate income taxes.[12]
    - According to the most recent data published by the Illinois Department of Revenue, of those businesses actually liable to pay the state's corporate income taxes (i.e., traditional C-Corporations), fully 92.67 percent that filed an Illinois corporate income tax return in 2010 paid $5,000 or less in income taxes, with almost 70 percent having no state corporate income tax liability whatsoever.[13]
    - In the current economy, there is little reason to believe business income tax relief will stimulate job growth in any event, given that businesses are already highly profitable, and still not creating jobs. Since the end of the Great Recession through the third quarter of 2013, corporate profits grew by 35.3 percent nationally, while wages grew by just 5.9 percent and gross domestic product growth was just 8.4 percent. Meanwhile, private sector job growth has lagged prior recovery periods, and has yet to replace all the jobs lost during the Great Recession, much less grown at the rate necessary to keep pace with new entrants into the labor market.[14]
- In fact, although owners of small businesses organized as flow-through entities (S-Corps, LLCs, partnerships and sole proprietorships) do pay the state's personal income tax on their share of the profits earned by the businesses they own, even reducing the state's personal income tax rate should not be expected to spur small business hiring or growth.[15]
    - According to a recent study conducted by Michael Mazerov at the Center on Budget and Policy Priorities, substantial evidence shows that "cutting state personal income taxes not only won't promote small business growth and job creation, it is likely over time to threaten the success of entrepreneurs by taking away from critical services like education."[16]
    - The Mazerov study, citing research conducted by the nonpartisan Congressional Budget Office, noted that even cutting federal income taxes does not spur significant hiring by businesses, because— as the Congressional Budget Office specifically found— the real reason businesses hire more workers is to meet growing demand for the products or services they produce—not tax policy.[17]
- On the other hand, ensuring Illinois has the fiscal capacity to invest adequately in education, infrastructure,[18] and other core services can be expected to support small businesses and stimulate economic growth.[19]
    - The evidence shows that providing access to a high quality public education is more likely than tax incentives to improve a state's economy over time.[20]
    - Indeed, an exhaustive academic study recently found that from 1963-1997, making real increases in public education funding at the state level had a statistically significant correlation to a state increasing personal income growth at a rate greater than other states.[21]
    - These findings were echoed by Jeffrey Thompson, who concluded that education spending has been found to raise state GDP, increase employment in metropolitan areas, and raise personal income at the state level.[22]
- Even if the desire is to reduce taxes paid by small businesses, focusing on corporate income taxes actually misses the primary tax paid by businesses generally and small businesses specifically—the local property tax. Here, the data are clear:
    - Property taxes represent almost 40 percent of the taxes businesses pay in Illinois, while corporate income taxes come in at just 8 percent and flow through personal income taxes just 4.9 percent of overall business taxes.[23]
    - Illinois is a tax outlier compared to other states in over-relying on property taxes to fund public services. Fully 51 percent of the business taxes paid in Illinois go to local governments, not the state, whereas nationally on average just 46 percent of business taxes go to local governments.[24]

- The primary driver of Illinois' over-reliance on local property taxes is education funding. Illinois currently ranks last in the nation in the portion of education funding covered by state rather than local revenue, and first in the nation in reliance on local property taxes to fund schools.[25]
    - This not only creates an unfair education funding system—because it ties school quality to local property wealth—but also creates a burdensome tax system for both businesses and people.
    - Over-relying on local property taxes to fund services is not the best way to tax businesses generally or small businesses in particular, because property taxes are a cost businesses must pay whether or not they are profitable. This approach to taxation takes needed sales revenue away from a business's ability to invest in operations or capital enhancements.
    - Over-relying on local property taxes is also an unfair way to tax families, because over time the rate of growth in state property taxes in Illinois has significantly outpaced the rate of growth in income for most people.[26]
    - Indeed, after inflation, property taxes in Illinois grew by over 48 percent, while median income grew by just 2.7 percent over the 1990-2005 sequence.[27] From 2005-2011, Illinois property taxes grew by just over eight percent in real, inflation-adjusted terms, while median income declined by -9.2 percent.[28]
    - So, if the goal is to reduce small business taxation while growing the economy, then the evidence strongly indicates that state tax policy should be reformed in a manner that builds the state's fiscal capacity to invest in core services—while lessoning reliance on the local property tax—rather than cutting state level corporate or personal income taxes.

3. WHY SMALL BUSINESS MATTERS.

Few would question the important role small businesses play in our nation's and state's respective economies. After all, of the more than 28 million businesses that existed nationwide in 2011, fully 99.9 percent were "small businesses" according to the federal Small Business Administration (SBA).[29] The SBA defines a small business as a company with less than 500 employees.[30] In 2011, Illinois had nearly 1.2 million businesses, of which 99.6 percent qualified as small businesses under the SBA definition.

Figure 1
Number of Businesses in Illinois by Firm Size, as of 2011

Employment Size	Number of Firms	Percent of Total
Non-Employers	**920,076**	**78.5%**
0-4	154,671	13.2%
5-9	39,988	3.4%
10-19	24,727	2.1%
<20	**1,139,462**	**97.2%**
20-99	22,208	1.9%
100-499	5,818	0.5%
<500	**1,167,488**	**99.6%**
500+	4,438	0.4%
Total	**1,171,926**	**100%**

Sources: United States Census, Statistic of U.S. Businesses, "U.S. & states, totals" (December 2013), http://www.census.gov/econ/susb; Non-employer from United States Census, Nonemployer Statistics, "U.S., States, and Counties (2002-2011)," http://www.census.gov/econ/nonemployer.

Now, it is certainly understandable if you believe that the SBA definition of a small business is somewhat overbroad, given that a company employing over 400 workers does not fit the classic portrayal of the "mom and pop" shop down the street. However, truly small businesses, those which have 20 employees or less, constitute the vast majority of businesses in Illinois. This is shown clearly in Figure 1, which provides a more detailed breakdown of small businesses in Illinois by number of workers employed.

In fact, as Figure 1 shows, most small businesses in Illinois (78.5 percent) are characterized as "non-employers," meaning that the only people working in those businesses are their respective owners. So, while the SBA definition may be overbroad, as it turns out the vast majority of small businesses, both nationally (97.9 percent) and in Illinois (97.2 percent) are truly small "mom and pop" type operations with 20 or fewer employees.[31]

Excluding non-employers, those truly small businesses in Illinois—the "mom and pop" shops with between 1 and 19 employees, are crucial to the state's labor market, having employed 836,750 workers in 2011, or 16.6 percent of all private-sector workers in Illinois that year.[32] Taken collectively, small businesses of all sizes employed 2.38 million Illinoisans in 2011, or 47.3 percent of the 5.04 million full-time workers employed in the state's private sector workforce.[33]

In addition to employing a significant number of Illinois workers, small businesses also contribute to the growth and vitality of the state by creating jobs. While job creation can be found in both small and large firms, the majority of net new jobs are created by small businesses.[34] Using its definition of a small business, the SBA estimated that 64 percent of new jobs created nationally between 1993 and 2011 were attributable to small businesses.[35] Using the most recent Business Employment Dynamics produced by the Bureau of Labor Statistics (**BLS**), Brookings Institute researchers—William Gale and Samuel Brown—found that employers with less than 20 employees, which is the size of the vast majority of small businesses in Illinois, accounted for approximately 20 percent of historic net job gains nationally from 1992 through the first quarter of 2012.[36] In fact, small businesses with less than 250 employees have historically accounted for 55 percent of net job gains.[37] Recent research indicates that young businesses—which are also typically small businesses—are the most dynamic drivers of job growth, representing fully 76 percent of all high growth businesses nationally in 2012.[38]

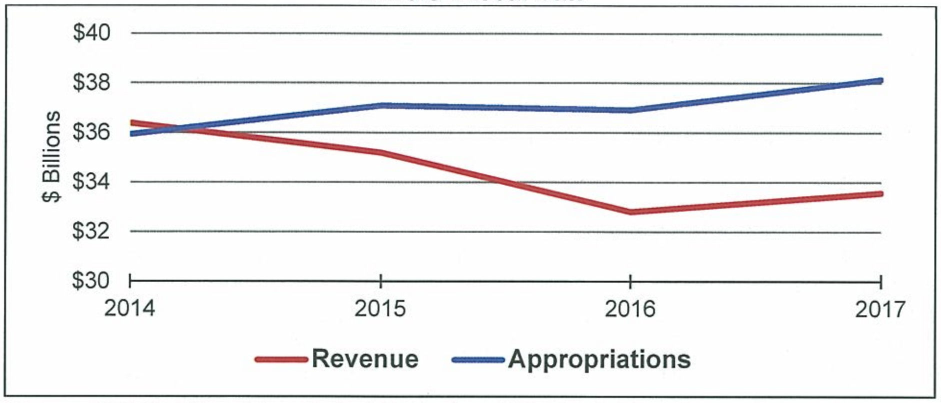
4. WHICH STATE POLICIES MOST SUPPORT SMALL BUSINESSES OVER THE LONG TERM?

In General, Tax Cuts and Incentives Have Little Impact on Improving a State's Economy—Investments in Core Public Services and Infrastructure, On the Other Hand, Better Promotes Growth Over the Long-Term.

Given their demonstrable importance to the state's economy, it is a legitimate public policy objective to support small businesses. The question then becomes, how best to do so? On the one hand, state government invests in providing core public services and goods—like education and infrastructure for instance—which small businesses need to thrive. On the other hand, to pay for those services and that infrastructure, taxes are imposed on businesses and people alike. Getting the balance right between making investments in core public services and raising adequate tax revenue in a sustainable, fair manner is crucial if small businesses specifically and the state's economy generally are to grow.

For Illinois, determining how to get that balance right is no academic inquiry. In fact, at some point over the next two years, Illinois decision makers will be forced to deal with the politically difficult issue of state tax policy generally – and how best to ensure Illinois has the ongoing fiscal capacity to fund core services small businesses rely on specifically. The reason for this is both simple and compelling: the temporary tax increases that became law in January of 2011 will begin to phase out over the FY2015-FY2016 sequence,[39] which creates the fiscal cliff pictured in Figure 2.

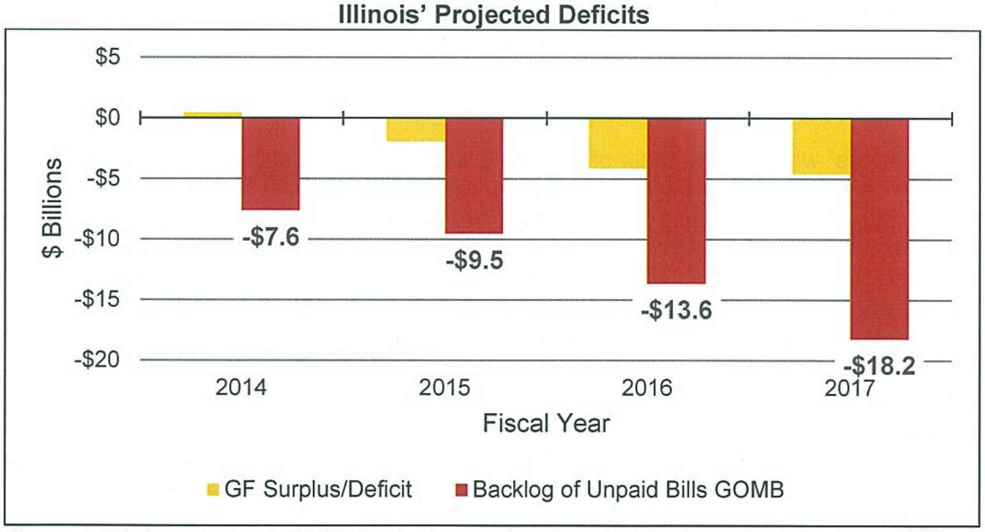
Figure 2
Illinois' Fiscal Cliff



Source: GOMB, *Three Year Budget Projection: FY2015-FY2017* (Springfield, IL: January 1, 2014).

The net loss of revenue resulting from that phase out—estimated to be $3 to $4 billion annually (after accounting for other natural revenue growth)[40]—will literally be impossible for the state fiscal system to absorb. That is because Illinois already has an accumulated deficit of at least $7.6 billion in its General Fund for the current fiscal year, FY2014, as shown in Figure 3.[41]

Figure 3
Illinois' Projected Deficits



Source: CTBA analysis of FY2014 budget: spending from CTBA, *Analysis of the FY2014 Illinois General Fund Budget* (Chicago: October 2013) and revenue from COGFA, *Monthly Briefing for the Month Ended: October 2013* (Springfield, IL: October 2013), 9; GOMB, *Three Year Budget Projection: FY2015-FY2017* (Springfield, IL: January 1, 2014).

That accumulated FY2014 deficit represents 31 percent of the scheduled appropriations for current services over the course of the year.[42] The state is in this precarious fiscal position despite both the new revenue from the aforesaid temporary tax increase, and having cut service spending by $4.7 billion in nominal dollars (that is, not adjusted for inflation or population growth) over the FY2009 through FY2014 sequence.[43] Since $9 out of every $10 spent on services funded through the General Fund go to education, healthcare, social services, and public safety, and the state's existing debt service repayment obligations are scheduled to continue increasing over time, decision makers will either have to replace the revenue being lost from the phase-out of the temporary tax increase, or implement significant spending cuts to the aforesaid core public services.

Some maintain the answer to the state's fiscal dilemma is relatively simple and straight forward from a small business standpoint—cut service spending and allow the temporary tax increases to expire, particularly the corporate income tax increase—and watch small businesses grow. While the populist appeal of relying on tax and spending cuts to stimulate private sector growth certainly exists, the data clearly indicate that taking such an approach not only wouldn't work, but would in all likelihood harm the state's economy.[44] Indeed, according to researchers Noah Berger and Peter Fisher at the Economic Analysis and Research Network (**EARN**), "the preponderance of evidence has shown" that simply reducing business taxes—and paying for those tax reductions with service cuts—has been both "inefficient and ineffective at stimulating growth" in the long run.[45]

That conclusion is consistent with recent meta-analyses of both business tax incentives specifically and business/individual income taxation generally. The extant research showing the lack of a meaningful correlation between individual and/or business income taxes on the one hand, and economic growth, hiring incentives or small business/entrepreneurial growth on the other, is abundant, compelling and spans the ideological spectrum.[46] A literature review completed by the Institute of Public Policy of the Harry S. Truman School of Public Affairs at the University of Missouri (the "**Truman Report**") found that, overall, "tax cuts do not stimulate economic growth and/or development in a state because the other side of the tax cut coin is cuts in public services."[47] This conclusion was echoed during a recent joint hearing of the Illinois House State Government Administrative Committee and Revenue and Finance Committee, by the Illinois Department of Commerce and Economic Opportunity, which testified that, "while incentives provide a critical set of tools for economic development, it is important to note that the core drivers for economic growth are investments in human capital, physical infrastructure, and technological innovation."[48]

In a similar vein, a recent study that focused on the stimulative impact on small business growth that flowed from cutting individual income taxes was conducted by Michael Mazerov at the respected Center on Budget and Policy Priorities. In that study, Mazarov concluded that the evidence shows "cutting state personal income taxes not only won't promote small business growth and job creation, [but] is likely over time to threaten the success of entrepreneurs by taking away from critical services like education."[49] Meanwhile, as concerns business incentives specifically, a meta-analysis published by the Lincoln Institute of Land Policy in 2012 specifically found that, while business taxes can play a role in explaining differences in economic activity among states, "this effect is fairly small and easily outweighed by differences in other factors."[50]

So what are these "other factors" within the domain of the public sector that actually help spur economic growth in the private sector? The answers are pretty clear from the research, with investments in core public services like education and core public goods like infrastructure leading the way.[51] As it turns out, entrepreneurs agree with the research about what really matters for small business. A recent survey of entrepreneurs who founded some of the fastest growing companies in the U.S. found that low tax rates were rarely cited as a factor in their site-selection decision making.[52] Instead, the entrepreneurs surveyed responded that the most important factors to them in choosing a site were, first and foremost, access to a talented local employee pool, and second, proximity to customers and suppliers.[53]

Creating the highly skilled labor force entrepreneurs desire requires a quality public education system, a subject that will be dealt with at length in Section 9 of this Report. As for the importance of infrastructure to businesses, well there is not much argument over the issue of whether infrastructure investments spur economic growth, but rather the degree to which they do so. "[E]conomists have long recognized the value of infrastructure. Roads, bridges, airports, and canals are conduits through which goods are exchanged."[54] According to a researcher at Wesleyan University, "The argument is simple. Infrastructure is a public good that produces positive externalities for production. The provision of adequate infrastructure is a necessary condition for private firms to be productive."[55] On the other hand, when needed investments in core services or infrastructure are cut, the economy is harmed. According to the Truman Report, "the preponderance of studies find evidence that cuts to some public services [e.g. education, police/fire] and infrastructure are detrimental to economic growth."[56]

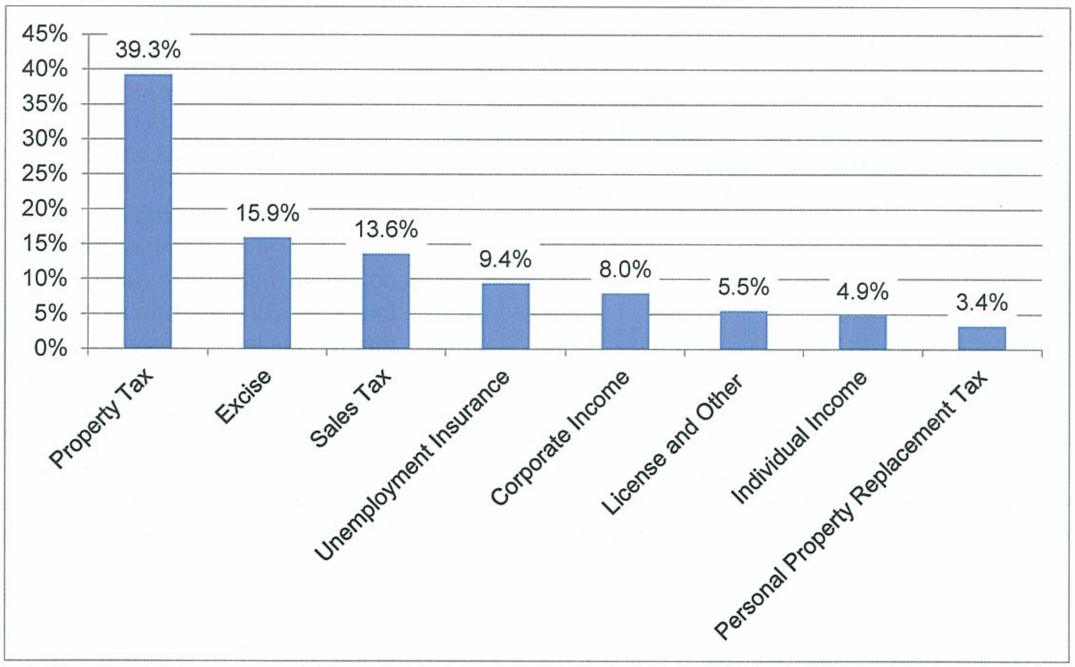
One of the best summaries of what really matters to business came from Eric Spiegel, president and CEO of the German based engineering company, Siemens AG. When explaining Siemens' decision to build a new manufacturing facility in the U.S., rather than overseas, Spiegel made it clear that public sector investments are paramount. According to Spiegel, "A lot of things that were offshored in the past were offshored because of lower-cost labor, but that's no longer the most important factor. The reasons you bring a plant like this to the United States are higher-skilled labor, access to the world's best research and development, and good, sound infrastructure. All those things together make the U.S. a good place to invest."[57]

5. BUSINESS TAXATION IN ILLINOIS.

Understanding how businesses are taxed at the state level helps explain why the evidence shows that cutting corporate income taxes is not the best way to stimulate the economy or support small businesses. Illinois is one of 44 states that imposes a corporate income tax. Currently, the corporate income tax rate in Illinois is seven percent, however, under The Taxpayer Accountability and Budget Stabilization Act (**TABSA**), that corporate income tax rate is scheduled to phase down from seven percent to 5.25 percent within the next two fiscal years.[58] As is the case in most other states, the corporate income tax in Illinois is only paid by businesses organized as a "C" corporation ("**C-Corp**"). Businesses that are organized as S-Corporations (**S-Corp**), Limited Liability Companies (**LLC**), partnerships or sole proprietorships are exempt from Illinois' corporate level income tax, no matter how profitable.

As shown in Figure 4, the corporate income tax is relatively less important in Illinois than other state and local taxes businesses pay, accounting for just 8 percent of total business tax burden. Meanwhile local property taxes account for nearly 40 percent of all taxes businesses pay in Illinois.

Figure 4
FY2012 State and Local Fees Paid by Businesses in Illinois



Sources: Andrew Phillips, Robert Cline, Caroline Sallee, Michelle Klassen, and Daniel Sufranski, Total State and Local Business Taxes: State-by-state estimates for fiscal year 2012 (Washington, DC: Ernst & Young and Council on State Taxation, July 2013), 10; Illinois Department of Revenue, *Annual Report of Collections and Distributions: Fiscal Years 2011 and 2012* (Springfield, IL).[59]

In fact, in 2011 businesses paid approximately 31 percent of all property taxes in Illinois.[60] This means businesses are paying just over one-third of the primary revenue used by the nearly 7,000 local governments in Illinois.[61] One reason Illinois businesses pay so much in local property taxes is clear, the state over-relies on property taxes as a revenue source to fund services. In fact, despite ranking relatively low in overall tax burden as a percentage of income—39th among all states according to the Federation of Tax Administrators,[62] Illinois ranks quite high—sixth nationally—in property tax reliance.

One unique tax that businesses pay in Illinois is the Personal Property Replacement Tax (**PPRT**), which is levied purely for the benefit of local governments. From an administrative standpoint, the PPRT is technically collected by the state—but then disbursed in full to local governments across Illinois. The PPRT was established in 1979 by Public Act (**PA**) 81SS1-1 during a special session of the 81st Illinois General Assembly. As the name suggests, the PPRT replaced the personal property tax local governments formerly assessed against businesses. The former personal property tax was based on the value of items utilized in the production of a business's products or services. Forty states and the District of Columbia still assess a local personal property tax against business.[63]

Unlike the Illinois state income tax, which exempts most businesses from taxation irrespective of profitability, partnerships, trusts, LLCs, S-Corps, and C-Corps alike are all subject to the PPRT. The PPRT assessed varies by business type, however, with C-Corps paying 2.5 percent of profits; and partnerships, trusts, most LLC's and S-Corps paying 1.5 percent of profits.*[64]

***IN ILLINOIS, LIMITED LIABILITY COMPANIES ARE NOT ASSIGNED A SPECIFIC TAX RATE FOR THE PERSONAL PROPERTY REPLACEMENT TAX. INSTEAD, LLCs CAN CHOOSE TO BE TAXED AT EITHER THE HIGHER C-CORP RATE OR LOWER S-CORP/PARTNERSHIP RATE, AND ARE REPORTED UNDER THE CATEGORY THEY SELF-SELECT. IT CAN REASONABLY BE ASSUMED THAT THE VAST MAJORITY OF THESE BUSINESSES WOULD SELF-SELECT THE LOWER RATES APPLICABLE TO PARTNERSHIPS AND S-CORPORATIONS, AND HENCE PRELIMINARILY BE INCLUDED IN THOSE CATEGORIES.**

For reporting purposes, the Illinois Department of Revenue refers to the state's corporate income tax and the local-only PPRT collectively as "business income taxes."[65] While on the one hand this is accurate, since both taxes are based on business profits, on the other it is quite misleading, because the PPRT does not benefit state government. Instead, it is a purely local revenue source—like the property tax is now, and the former personal property tax was before being replaced by the PPRT. Because of IDOR'S reporting, however, the local PPRT tax rate is often incorrectly combined with the state's corporate income tax rate when comparisons of state-level corporate income taxes are made. This leads many to overstate the state corporate income tax rate in Illinois as this combined rate, which in turn skews national comparisons, as the combined local PPRT/state corporate income tax rate in Illinois is contrasted with state level only corporate income tax rates applicable elsewhere. Such comparisons artificially inflate the Illinois state rate vis-à-vis other states. These comparisons also mislead the public because they neither account for the personal property taxes that are still assessed in the vast majority of other states, nor acknowledge that the PPRT generates purely local rather than state level revenues.

Figure 5
Sampling of Tax Year 2013 State Level Corporate Income Tax Rates[66]

Illinois: 7% until 2015, then 5.25%	
Midwest	**Other Big States**
Iowa: 6% – 12% (12% @ $250,000)	Pennsylvania: 9.99%
Indiana: 8%	New Jersey: 9%
Wisconsin: 7.9%	California: 8.84%
Missouri: 6.25%	New York: 7.1%
Kentucky: 4% – 6% (6% @ $100,000)	Florida: 5.5%
Michigan: 6%	

Source: Federation of Tax Administrators, State Corporate Income Tax Rates Table – as of January 1, 2013, http://www.taxadmin.org/fta/rate/corp_inc.pdf

From the perspective of a business owner, the PPRT is far preferable to the personal property tax that still pertains in 40 other states. The reason for this is simple. Because the PPRT is based on profits, it is a variable tax that is paid only after a business is making money. That is better than a charge on personal property which a business would have to pay irrespective of profitability.

As illustrated in Figure 6, in 2010—the most recent data available—nearly 185,000 businesses had a PPRT tax liability, 82 percent of which were S-Corps and partnerships.[67] The vast majority of the PPRT tax liability—approximately $634 million or 66 percent, however—was paid by C-Corps.[68]

Figure 6
2010 Illinois PPRT Liability

Business	Total Number of Filers	Number of Filers with Tax Liability	Total PPRT Liability ($ millions)
C-Corp	110,577	33,359	$633.6
S-Corp	236,425	124,082	$238.8
Partnership	112,702	27,141	$92.4
Total	**459,704**	**184,582**	**$964.8**

Source: Communication with the Illinois Department of Revenue in May 2013

6. ALLOWING THE STATE'S CORPORATE INCOME TAX RATE TO PHASE DOWN UNDER TABSA WILL SIGNIFICANTLY DIMINISH ILLINOIS' CAPACITY TO FUND CORE SERVICES AND INFRASTRUCTURE, WITHOUT BENEFITING MOST BUSINESSES GENERALLY OR SMALL BUSINESSES SPECIFICALLY.

As indicated previously, the evidence overwhelmingly shows that reducing corporate and individual income taxes are not effective ways to support small businesses or spur the economy. Yet, that is precisely what is about to occur in Illinois. TABSA, which became law in January of 2011, temporarily increased the Illinois corporate income tax rate from 4.8 percent to seven percent.[69] Under TABSA, that corporate income tax rate is scheduled to phase down from seven percent to 5.25 percent by FY2016. Although, as shown previously in Figure 2, the loss of General Fund revenue this phase down will cost the state is dramatic, from a business perspective the scheduled corporate income tax rate reduction can reasonably be expected to have, at best, a minimal financial impact. The reason for this is simple. As shown in Figure 4, the pending corporate income tax reduction applies to a relatively minor percentage (8 percent) of the Illinois taxes businesses actually pay.

Not only will the overall financial impact on businesses be relatively insignificant, but this pending rate reduction can be expected to reach very few businesses in Illinois overall, and particularly few small businesses. That is because most small businesses are exempt from ever paying the corporate income tax in Illinois—no matter how profitable—since they are organized as S-Corps, LLCs, sole proprietorships, or partnerships. Instead of paying corporate income taxes, the owners of these pass-through entities pay personal income taxes on the profits of the businesses they own, in accordance with their respective ownership interests in the applicable business. As shown previously in Figure 4, those individual income tax payments made by owners of pass-through entities accounted for just 4.9 percent of all business taxes paid in the most recent year for which there are data. It is only generally larger businesses which are organized as C-Corps that by law are ever liable to pay the Illinois corporate income tax. Hence, even very broad corporate income tax relief in Illinois would reach few small businesses.

Moreover, given recent trends in how businesses are being structured, it is highly likely that broad-based corporate income tax relief in Illinois will reach even fewer small businesses—or businesses of any size for that matter—in the future. That is because, as shown in Figure 7, over time the vast majority of new businesses are being organized as flow-through S-Corps rather than traditional C-Corps.

Figure 7
Trends In Corporate Organization, 1984-2010

Source: Illinois Department of Revenue, *Supplement to Analysis of Selected Illinois Business Tax Incentives* (Springfield, IL; February 2011), 1 and CTBA analysis of data provided by the Illinois Department of Revenue for years 2009-2010 (May 2013).

That said, not even very many large businesses pay the Illinois state corporate income tax. As shown in Figure 8, according to the most recent IDOR data, fully 92.8 percent of all businesses that filed an Illinois corporate income tax return in 2010 paid $5,000 or less in income taxes to the state that year, with almost 70 percent of corporate filers having no income tax liability whatsoever. This is not due to some weird quirk in Illinois corporate income tax law. In fact, most businesses that do not have corporate income tax liability in Illinois, also do not have any federal income tax liability.[70]

Figure 8
Illinois Corporate Income Tax Liability: Tax Year 2010

Liability Range	Total Filers	Percent of Filers	Percent of Liabilities
$0	77,900	69.90%	0.00%
$0 ≤ $5,000	25,591	22.9%	1.50%
>$5,000 ≤ $10,000	2,512	2.30%	1.00%
>$10,000 ≤ $50,000	3,071	2.80%	4.00%
>$50,000 ≤ $100,000	794	0.70%	3.20%
>$100,000 ≤ $500,000	1,122	1.00%	14.40%
>$500,000 ≤ $1,000,000	226	0.20%	8.90%
>$1,000,000 or More	303	0.30%	67.00%
Totals	111,519	100.00%	100.00%
Corporations with any tax liability	**33,619**	**30.10%**	**100.00%**

Source: *Tax Incentives in Illinois: Hearing on Illinois Tax Incentives and Policy Before the H.R. J. Comm. On State Government Administration and Revenue and Finance*, 2014 Leg., 98th Sess. Slide 14 (IL. 2014) (Illinois Department of Revenue data presented by COGFA).

On the flip side, only 5 percent of all corporate filers had Illinois state income tax liability that exceeded $10,000 in 2010. The fact that very few businesses have anything that resembles a significant state-based corporate income tax liability is not unique to Illinois. As it turns out, the data make it quite clear that state income tax liability is relatively insignificant for businesses nationwide.

Figure 9 shows how much corporations paid in corporate income taxes to all 44 states that impose such a tax nationally, as a percentage of their aggregate net income before taxes, as reported to the Internal Revenue Service. The resulting percentage represents the overall effective state corporate income tax rate paid by all businesses in America to all states that impose a corporate income tax. Note that in 2010, the last year for which there are data, businesses paid just 2 percent of their total net income in aggregate, state-level corporate income taxes nationwide, with just 3.7 percent of the national total attributable to Illinois.[71] This means that if Illinois eliminated its corporate income tax all together, the overall effective state corporate income tax rate would decline by just 0.07 percent.

Figure 9
Corporate Tax Liability Nationally ($ Millions)

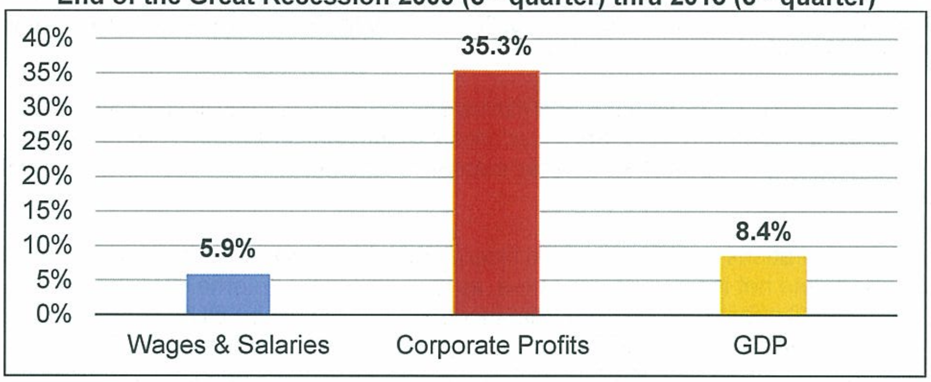
	1998	2003	2007	2008	2009	2010[72]
Total state corporate income taxes paid nationwide*	$31,089	$28,384	$52,915	$49,860	$39,278	$36,646
Net Income (before payment of income taxes) of corporations nationwide**	$1,091,150	$1,175,609	$2,252,874	$1,806,890	$1,614,867	$1,836,377
Effective Total State Income Tax Rate***	2.85%	2.41%	2.35%	2.76%	2.43%	2.00%
*Annual Survey of State Government Tax Collections—U.S. Census Bureau						
**SOI Tax Stats—Returns of Active Corporations – Table 1 – IRS						
***Simple math—line 1 divided by line 2						

So the belief that allowing Illinois' corporate income tax rate to phase down as scheduled under current law will somehow stimulate small business growth is simply not supported by the data. On the one hand, very few small businesses pay the Illinois state corporate income tax to begin with and on the other, the Illinois corporate income tax is a relatively small portion of the total business tax burden in the state—and a very small portion of the aggregate corporate income tax burden imposed by all states.

7. CURRENT NATIONAL TRENDS REINFORCE THE CONCLUSION THAT CUTTING STATE LEVEL CORPORATE INCOME TAXES WILL NEITHER INCENTIVIZE BUSINESSES OF ANY SIZE TO CREATE JOBS NOR STIMULATE THE ECONOMY.

It is especially questionable that reducing corporate income tax burden at this point in time will have any stimulative effect on the economy overall or job creation specifically. In theory, when business tax burden is reduced, it frees up earnings to invest in, among other things, job creation. However, as it is corporations are already highly profitable, with the rate of growth in corporate profits vastly outstripping both gross domestic product (**GDP**) and wage growth since the Great Recession ended. Figure 10 shows the percentage growth in corporate profits versus wages and GDP, from the end of the Great Recession through the third quarter of 2013.

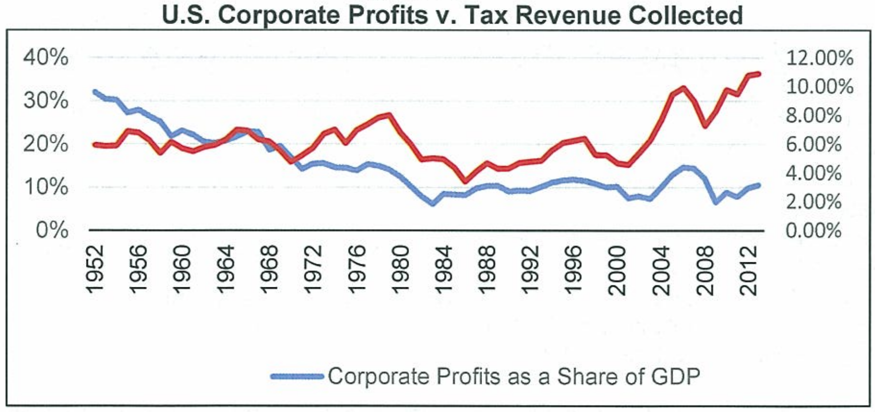
Figure 10
Percentage GDP, Profit and Wage Growth since the End of the Great Recession 2009 (3rd quarter) thru 2013 (3rd quarter)



Source: Bureau of Economic Analysis; Inflation Adjusted to CPI

Meanwhile, corporate profits as a share of the nation's total GDP is approaching an all-time high. On the flip side, the share of federal taxes paid by businesses is approaching an all-time low, as shown in Figure 11.

Figure 11
U.S. Corporate Profits v. Tax Revenue Collected



Source: Federal Reserve, Historical Tables: Receipts by Source 1934-2018; Federal Reserve Economic Data obtained using FRED, Corporate Profits/GDP.

The relatively low combined state and federal income tax burden of businesses in America is nothing new. After all, when compared to other OECD nations, the overall tax burden in the U.S. of 24.3 percent of GDP that pertained in 2012, the last year for which complete data for comparison are available, is significantly less than the OECD average of 34.6 percent.[73]

Yet, despite the strong rebound in profitability for corporate America, job growth since the end of the Great Recession has been disappointing. In fact, according to the Bureau of Labor Statistics, the U.S. economy has produced about 6.3 million new jobs.[74] This is still less than the 7.5 million jobs lost during the Great Recession[75]—which ended almost five years ago in June of 2009. After factoring in the millions of people who have dropped out of the labor market, as of September 2013, 8.3 million new jobs were still needed to recover fully from the Great Recession.[76] That confluence of factors, high corporate profitability combined with low job growth, makes it unreasonable to believe that a state-level corporate income tax reduction can effectively function as a tool for encouraging hiring at this time.

In fact, according to the Congressional Budget Office (**CBO**), even federal tax policy—which is far more monetarily significant than state-level tax policy—plays a statistically inconsequential role in encouraging businesses to hire additional employees. Indeed, the CBO found that private sector demand for a business's products or services is what really motivates a business to hire more workers.[77] This finding by the CBO is consistent with recent meta-analyses of both business tax incentives specifically and income taxation generally. The extant research showing the lack of any meaningful correlation between business income taxes on the one hand, and economic growth, hiring incentives, or small business/entrepreneurial growth on the other, is abundant, compelling and spans the ideological spectrum.[78]

The bottom line here is clear. Considering all these factors together, it is simply not reasonable to conclude that allowing a very small number of businesses in Illinois—few of which if any will be small—to keep even more of their profits will stimulate job growth at this juncture in time given that: (i) corporate profits are already quite high, growing by over 35 percent post Great Recession; (ii) so few businesses pay any state corporate income taxes in Illinois; (iii) the overall state corporate income tax liability of businesses to all states that impose an income tax constitutes such a low cost (2.0 percent of net profit before taxes) to businesses nationally; (iv) despite the resurgence in corporate profitability, job growth has been disappointing; and (v) the primary factor that motivates a business to hire more workers is growing demand for that business's products or services—not tax policy.

Of course, while overall the research conducted across a broad ideological spectrum confirms that there is no statistically meaningful relationship between state tax policy on the one hand and small business growth or entrepreneurial activity on the other,[79] there are always outliers.

The Tax Foundation, which issued a report in 2012 that purported to be a review of the research on the subject, found that state-level tax increases harm economic growth.[80] The Tax Foundation based its state tax conclusion on seven, separate studies completed by groups or academics unaffiliated with the Tax Foundation. However, an objective analysis of that 2012 Tax Foundation report by the Center on Budget and Policy Priorities (**CBPP**) found that:

> ***"The Tax Foundation mischaracterized or exaggerated the findings of three of the seven articles it cited, and the conclusions of a fourth article it cited are contradicted by a much more recent paper by the exact same author (which the Tax Foundation failed to include in its review.)"***[81]

Indeed, the CBPP analysis of the Tax Foundation's study concluded that:

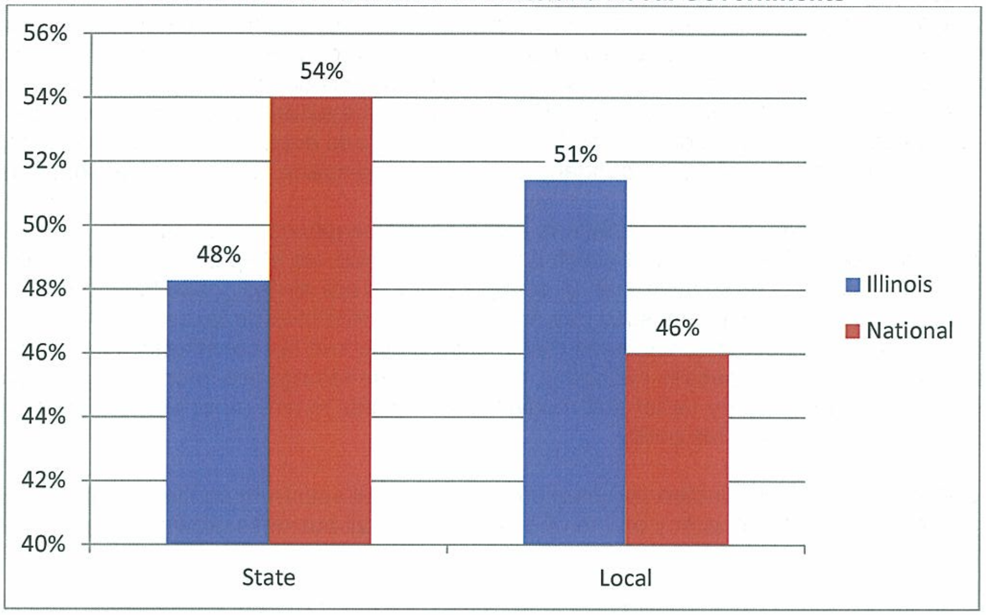
> ***"The Tax Foundation's statement that 'empirical economic literature speak[s]... strongly in unison' on this topic is simply false. To the contrary, there is no clear research evidence that lower taxes help state economies grow."***[82]

8. GETTING TAX POLICY RIGHT WILL HELP SUPPORT SMALL BUSINESSES SPECIFICALLY AND THE STATE ECONOMY GENERALLY.

This is not to suggest that tax policy is entirely irrelevant to small business. It is just that what is truly important is getting tax policy right, and thereby ensuring the public sector has the capacity to make the investments in core public services and infrastructure small business needs. Getting tax policy right in very general terms means taxes should be assessed fairly, at the lowest rates with the broadest bases practicable, and in a manner that both responds to the modern economy and generates adequate revenue to sustain public investments in core services and infrastructure over time—the very investments which the research shows support small businesses and spur the economy.

As it turns out, the most significant tax small businesses pay is the property tax—which is not levied by the state of Illinois but instead by local governments. As referenced previously, although overall Illinois is relatively low-tax compared to the rest of the nation, ranking 39th in total state and local tax burden as a percentage of income,[83] Illinois' property tax reliance is relatively high compared to the rest of the country, ranking sixth overall.[84] The net result is Illinois is very much a tax outlier in its business tax mix, as shown in Figure 12.

Figure 12
FY2012 Taxes/Fees Paid by Businesses
Breakdown of Distribution to State and Local Governments[85]

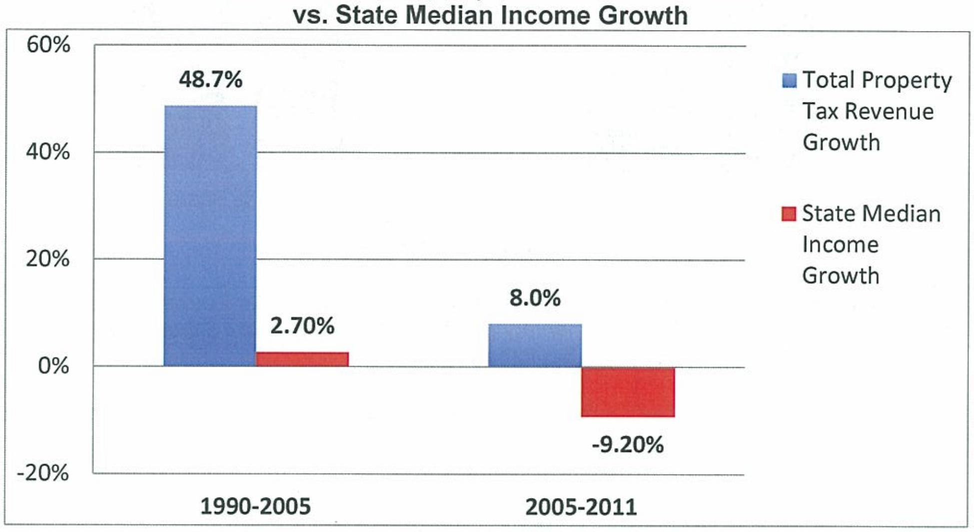


Sources: Andrew Phillips, Robert Cline, Caroline Sallee, Michelle Klassen, and Daniel Sufranski, *Total State and Local Business Taxes: State-by-state estimates for fiscal year 2012* (Washington, DC: Ernst & Young and Council on State Taxation, July 2013).[86]

So, while nationally 54 percent of state and local taxes businesses pay go to state governments, with 46 percent going to local governments, it is nearly reversed in Illinois, with just 48 percent of business taxes going to the state while 51 percent go to local governments.[87] Over-relying on local property taxes to fund services is not the best way to tax businesses generally or small businesses in particular. That is because property taxes are a cost businesses must pay whether or not they are profitable. This approach to taxation takes needed sales revenue away from a business's ability to decide how best to invest in its operations.

From an individual's standpoint, moving from over-reliance on local property taxes to more state-based revenue sources to fund public services is desirable as well. This is because Illinois is so over-reliant on property taxes in its state and local revenue mix, that property tax growth is far outstripping growth in income for the vast majority of Illinois residents, as shown in Figure 13.

Figure 13
Illinois Total Property Tax Revenue Growth vs. State Median Income Growth



Source: All data inflation adjusted to 2011 by CPI; Income Data: US Department of Census Property Tax Data: Illinois Department of Revenue

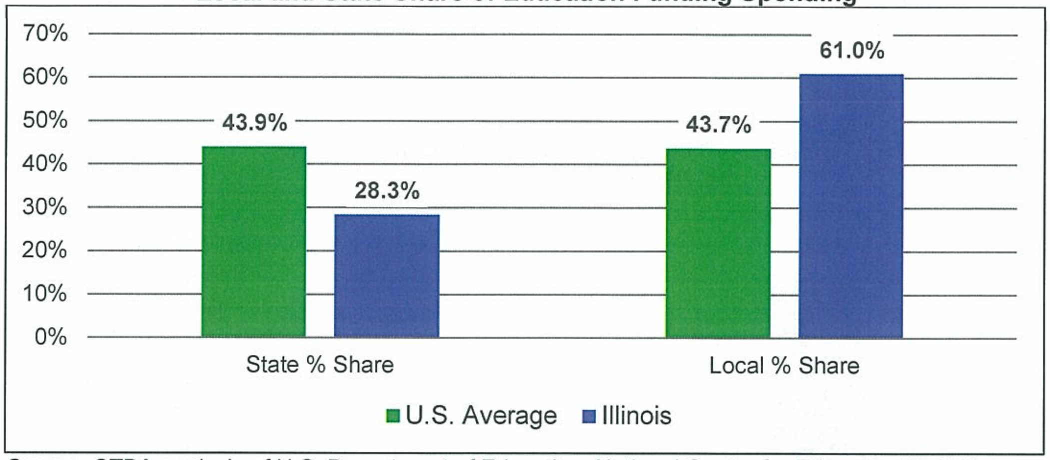
Which begs two important questions. First, why is Illinois so over-reliant on property taxes? Second, does Illinois otherwise have tax policy right at the state level?

9. THE TIE BETWEEN ILLINOIS' OVER-RELIANCE ON PROPERTY TAXES AND EDUCATION FUNDING.

Reforming state tax policy in a manner that maintains the public sector's capacity to invest adequately in core services—while lessening reliance on the local property tax—would be a more meaningful way to reduce small business tax burden than cutting corporate income taxes, because it would lower a business's hard costs, making more of its sales revenue available for operational or capital uses. The corollary benefit is that shifting from over-relying on property taxes to more state-based revenue generated from income and sales taxes is a better way to tax people as well. Which makes it essential to determine why Illinois is a national tax outlier in its over-reliance on local property taxes in its overall mix of state versus local taxes businesses pay. Again, the data here are clear and compelling. Illinois over-relies on property taxes because the state fails to pay its fair share of the cost of public education.

Since FY2010, the last year in which additional federal funding for K-12 was available under the American Recovery and Reinvestment Act (**ARRA**), overall state spending on K-12 education in Illinois has declined by some $578 million.[88] According to the U.S. Census Bureau, the funding cuts to K-12 Illinois implemented in FY2011 represented the largest year-to-year percentage cut in education funding made by any state.[89] The net result is that today state-level funding will cover less than the 28.3 percent of K-12 education costs Illinois state-level funding covered back in FY2011, when Illinois already ranked 50th—dead last in the country—in the portion of education funding covered by state rather than local tax revenue. It also means local funding—read as property tax revenue—will be covering more than the 61 percent of K-12 education costs it covered in FY2011. Overall, Illinois relies more on local property taxes to fund schools than any other state.

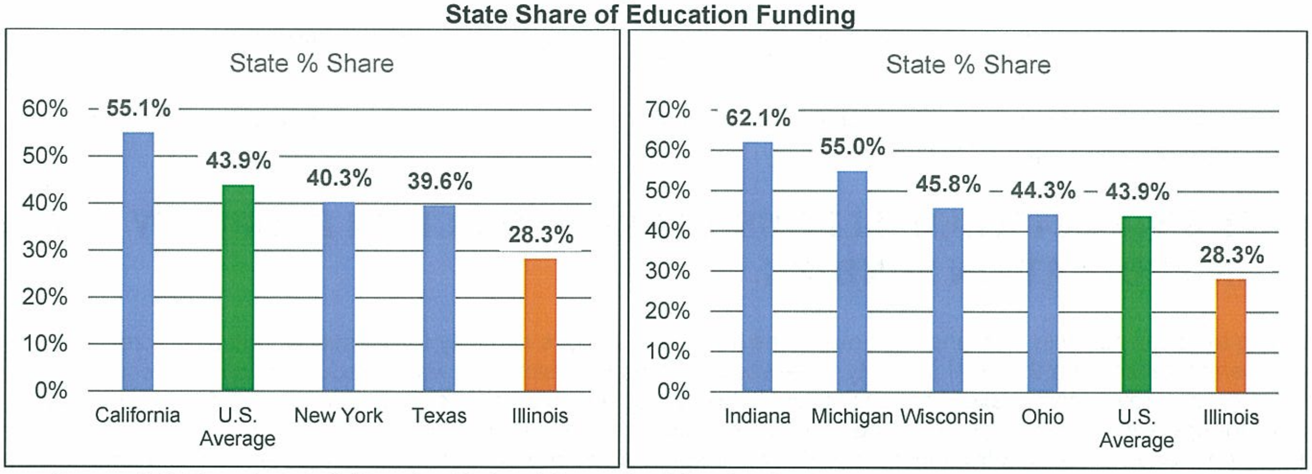
Figure 14
Local and State Share of Education Funding Spending



Source: CTBA analysis of U.S. Department of Education, National Center for Education Statistics, *Revenues and Expenditures for Public Elementary and Secondary Education: School Year 2010-2011 (Fiscal Year 2011)* (Washington, DC: September 2013), 7.[90]

Figure 15 shows how Illinois stacks up with other large states and the Midwest states in the portion of education funding that comes from state-based resources.

Figure 15
State Share of Education Funding



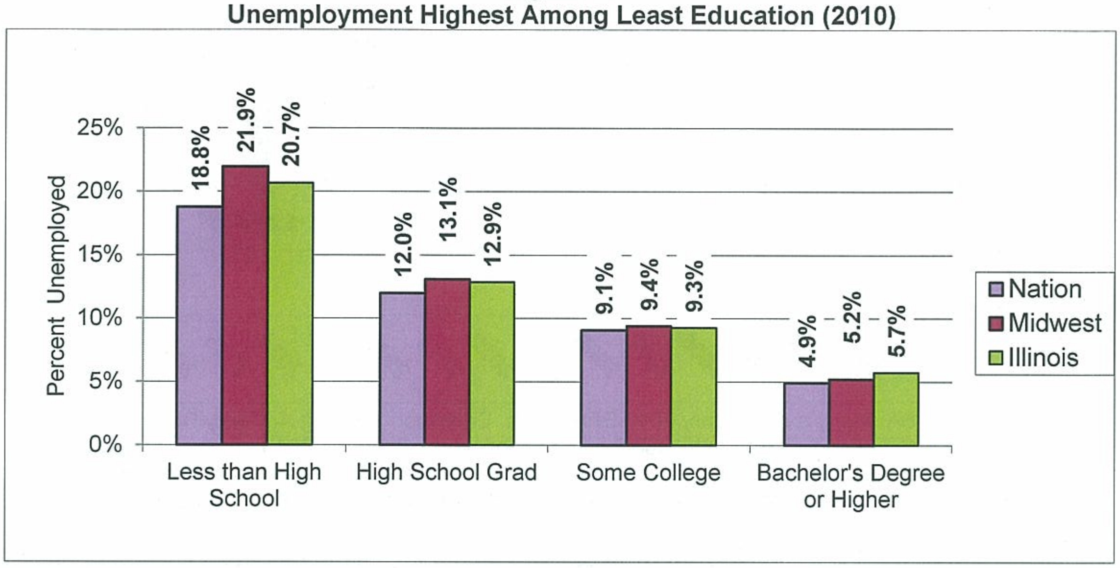
Source: U.S. Department of Education, National Center for Education Statistics, *Revenues and Expenditures for Public Elementary and Secondary Education: School Year 2010-2011 (Fiscal Year 2011)*, (Washington, DC: September 2013).[91]

So, to lessen the over-reliance on local property taxes used to fund education, more state-based resources from income and sales taxes are needed.

From a small business perspective it would be quite beneficial for the state to enhance its investment in public education. That is because there is one, key policy initiative state government can pursue that—according to researchers Noah Berger and Peter Fisher—the evidence shows is more likely to "strengthen the overall state economy than anything else": provide access to a high quality public education.[92] This finding was echoed by Jeffrey Thompson, who concluded that education spending has been found to raise state GDP, increase employment in metropolitan areas, and raise personal income at the state level.[93] The reasons for this are simple enough to understand. Higher levels of educational attainment strongly correlate to lower levels of unemployment and higher wages.[94] In essence, a quality public education helps build a labor force that has the numeracy and literacy skills required for good jobs in the modern economy.

From the small business perspective, a quality K-12 system is especially crucial, since the local labor force is the primary pool from which most small businesses tend to hire. From an individual's viewpoint, while having a high quality K-12 education may not guarantee a bright economic future, not receiving a quality K-12 education almost certainly guarantees long-term economic struggles, from both wage and employability perspectives.[95] Hence, it is no wonder a study which analyzed state economic competitiveness from 1963-1997 found that increased real, inflation-adjusted funding of public education had a statistically significant correlation to that state increasing personal income growth at a rate greater than other states.[96]

Figure 16
Unemployment Highest Among Least Education (2010)



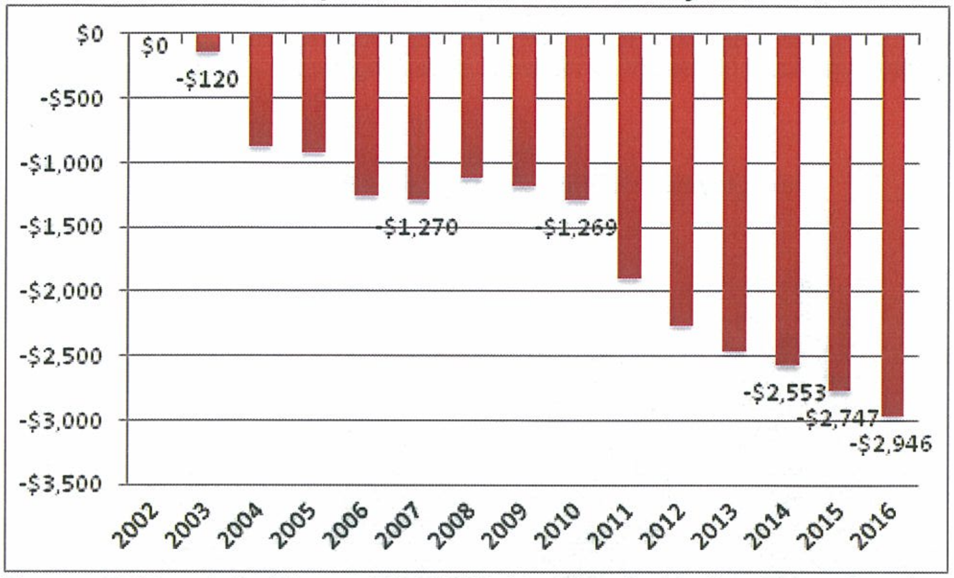
Source: Economic Policy Institute Analysis of Current Population Survey Data

Unfortunately, Illinois is not making the investments needed to create the high quality public education system so essential to state and small business competitiveness in a modern economy. Consider that, despite having the fifth largest population and economy in the nation,[97] Illinois ranks 29th in per-capita education spending.[98] Illinois' education funding levels not only make it a national laggard, but also fall well short of the state's own standards.

The nonpartisan Education Funding Advisory Board (**EFAB**) is required by law to recommend a "Foundation Level" of per pupil spending that is sufficient to cover the cost of an adequate K-12 education. The Foundation Level is supposed to include most of the basic costs of educating a "non-at-risk" child, that is, a child with a reasonable likelihood of academic success. The Foundation Level does not include the cost of significant items, like transportation, special education, and educating children who are English language learners or live in poverty.

In FY2003, the state's enacted Foundation Level was $120 less per child than the EFAB recommendation tied to the actual, base cost of educating a non-at-risk child. If the FY2014 Foundation Level were to be funded fully (it will not be, as the state will prorate funding for the Foundation Level at 89 percent of the amount appropriated in the budget)[99], the state's Foundation Level would nonetheless still be at least $2,553 less per child than the EFAB recommendation, as shown in Figure 17.

Figure 17
Dollar Shortfall in State Per-Pupil K-12 Education Funding to Meet EFAB Adequate Education Standard by Fiscal Year



Sources: CTBA analysis of January 2013 EFAB data. Education Funding Advisory Board, *Illinois Education Funding Recommendations*, (Springfield, IL: January, 2013), p. 9. Appropriations adjusted using ECI and Midwest Medical Care CPI (for Healthcare) from the BLS as of January 2013, and population growth from the Census Bureau as of January 2013.

According to the Illinois State Board of Education, the cost of filling the gap between the state's actual Foundation Level and the EFAB recommendation is some $4.7 billion.[100] Given that Illinois has an accumulated General Fund deficit of at least $7.6 billion in FY2014, the state simply does not have the current fiscal capacity to invest more in K-12 education. With the loss of another $3-$4 billion in annual revenue the state will absorb under the scheduled decrease in the Illinois individual and corporate income tax rates under TABSA, however, there is no reasonable likelihood that Illinois will have the capacity to invest more in K-12 education at the state level.

10. FLAWED TAX POLICY IS THE PRIMARY CAUSE OF ILLINOIS' FISCAL PROBLEMS THAT HURT SMALL BUSINESS.

The reason Illinois does such a poor job of funding schools from state resources—and hence the reason for high property taxes—turns out to be poor overall tax policy. Illinois' tax policy is so flawed that it has resulted in the state running a General Fund deficit in each of the last 23 years.[101]

The General Fund Budget passed for the current fiscal year—FY2014—authorizes $36.2 billion in FY2014 spending. Of that amount, $50 million was dedicated to covering some of the unpaid bills left over from FY2013, while another $11.12 billion or 31 percent represents nondiscretionary spending on hard costs over which decision makers have no discretion, like debt repayment, pension contributions, and statutory transfers out.[102]

That leaves $25.02 billion appropriated to fund current services—however—the budget indicates that $500 million of this aggregate service appropriation will not be spent, leaving a net service appropriation for FY2014 of $24.52 billion. Of that $24.52 billion, $9 out of $10 will go to the four core service areas of: Education (PreK-Higher Ed, 35 percent); Healthcare (29 percent); Human Services (20 percent) and Public Safety (6 percent).

It should be noted that, continuing a long-term trend, net spending on services in FY2014 is scheduled to be $173 million less in nominal and $755 million less in real, inflation-adjusted dollars than last year in FY2013.[103] In fact, General Fund expenditures for services in FY2014 are scheduled to be $4.7 billion less in nominal dollars than they were in FY2009, a mere five years ago.[104]

Yet, despite the revenue raised by the temporary tax increases under TABSA and the aforesaid significant cuts to service spending over the last five years, the state will not have enough revenue to cover the $24.52 billion appropriated for services in FY2014. In fact, the General Fund will end FY2014 with an accumulated deficit that will range from $7.96 billion (based on the revenue estimates contained in House Resolution 389), to $7.59 billion (using the revenue estimates of the state Commission on Government Forecasting and Accountability or "**COGFA**"). That means anywhere from 32.46 percent to 30.96 percent of the net, $24.52 billion in scheduled spending on services in FY2014 will be deficit spending.

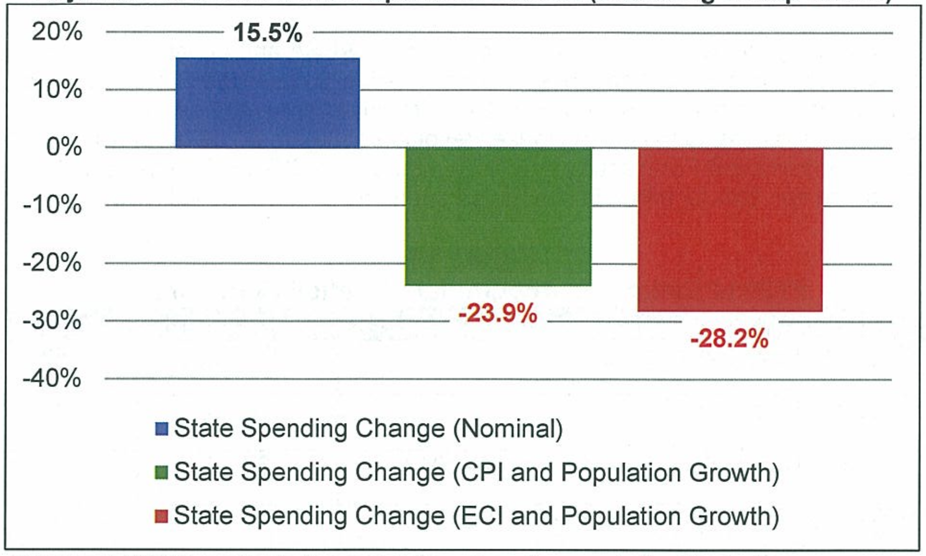
Figure 18
FY2014 Estimated Accumulated Deficit ($ Billions)

	Category	HR 389	COGFA
(i)	Projected FY2014 Revenue	$35.45	$35.82
(ii)	Projected FY2014 Hard Costs	$11.12	$11.12
(iii)	Projected Deficit Carry Forward from FY2013	$7.76	$7.76
(iv)	Projected Net FY2014 General Fund Revenue Available for Services	$16.56	$16.93
(v)	Projected Net General Fund Service Appropriations	$24.52	$24.52
(vi)	Estimated Minimum FY2014 General Fund Deficit	($7.96)	($7.59)
(vii)	Estimated Deficit as a Percentage of General Fund Service Appropriations	-32.46%	-30.96%

Source: Appropriations for FY2014 from CTBA analysis PA 98-34, PA 98-35, PA 98-17, PA 98-33, PA 98-27, PA 98-64, PA 98-50, passed by the 98th General Assembly; and hard costs COGFA, *State of Illinois Budget Summary: Fiscal Year 2014* (Springfield, IL: August 1, 2013), 26. Revenue estimates from COGFA, *Monthly Briefing for the Month Ended: October 2013* (Springfield, IL: October 2013), 9 and HR 389 of the 98th Illinois General Assembly.

That is a significant deficit—but one that was not caused by overspending on services. Consider that irrespective of the inflation metric used, the Consumer Price Index (**CPI**) or Employment Cost Index (**ECI**), real General Fund spending on services will be significantly less in FY2014 than in FY2000, as shown in Figure 19. While in nominal dollars, spending on services increased over the FY2000-2014 sequence by 15.5 percent, in real, inflation-adjusted terms, state spending declined by 23.9 percent (CPI) or 28.2 percent (ECI) depending on the inflation metric used.

Figure 19
FY2014 General Fund Services
Appropriations Relative to FY2000, in Nominal Dollars and Adjusted for Inflation and Population Growth (excluding Group Health)



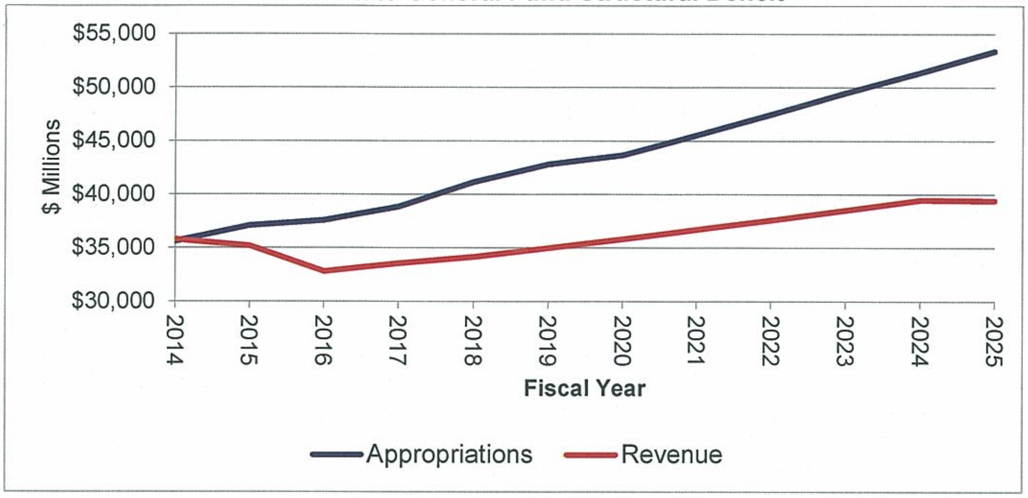
Sources: FY2000 unadjusted appropriations from Governor's final budget summary for FY2000; and FY2014 CTBA analysis SB 2555, SB 2556, HB 206, HB 208, HB 213, HB 214, HB 215, passed by the 98th General Assembly. Inflation for healthcare inflated by Midwest Medical Care CPI; all other appropriations adjusted using ECI-C and Midwest CPI from the BLS as of January 2014, and population growth from the Census Bureau as of January 2014.

Moreover, there really is not much left to cut that would not result in lowering service quality. In fact, compared to the rest of the nation, Illinois is a very low spending and small government state. Consider that:

- In calendar year 2012, Illinois had the fifth largest population, fifth highest overall state GDP, and 12th highest state GDP per capita in the nation.[105]
- Despite that, in FY2012 Illinois ranked 28th in General Fund spending on services per capita,[106] and 36th in General Fund spending on services as a share of GDP.[107]
- In 2011, (the most recent year for which there are data) Illinois ranked 49th, next to last among all 50 states, in number of state workers per 1,000 residents.[108]

For over a decade, CTBA has pointed out that the Illinois tax system consistently does not generate enough General Fund revenue to maintain delivery of the same level of public services from year-to-year after adjusting for inflation. This remains the case in FY2014. The ongoing mismatch in the state's General Fund between the lower rates of growth for revenue on the one hand, and the pace of increase in the cost of maintaining service levels, and covering the scheduled growth in payments under a state's extant debt service on the other, is commonly called a "structural deficit." Illinois' structural deficit is shown in Figure 20.[109]

Figure 20
Illinois State General Fund Structural Deficit



The structural deficit depicted above: (i) assumes the final appropriations for FY2014 and uses GOMB's appropriation projections for FY2015-FY2017;[110] (ii) uses COGFA's FY2014 revenue estimate;[111] and (iii) uses GOMB's revenue estimates for FY2015-FY2017.[112] It also assumes that the state maintains constant spending on services in real terms from FY2018 through FY2025, meaning that no programs are expanded or added, and that revenue will grow at historic annual rates.[113] It should also be noted that the revenue declines that occur in FY2015 and FY2025 are due to the expiration of the temporary income tax increases currently scheduled under TABSA.

Figure 21 depicts Illinois' structural deficit assuming two important changes. First, spending is projected using the reduced pension contributions that pertain under the new pension law, PA 98-599.[114] That law is currently being contested and may be found unconstitutional.

Second, it estimates how revenue growth would develop if there were no phase-out of the temporary tax increases under TABSA, and the current income tax rates (corporate and individual) were made permanent.

Figure 21
Illinois State General Fund Structural Deficit
with Tax Increase Kept and Reduced Pension Payments

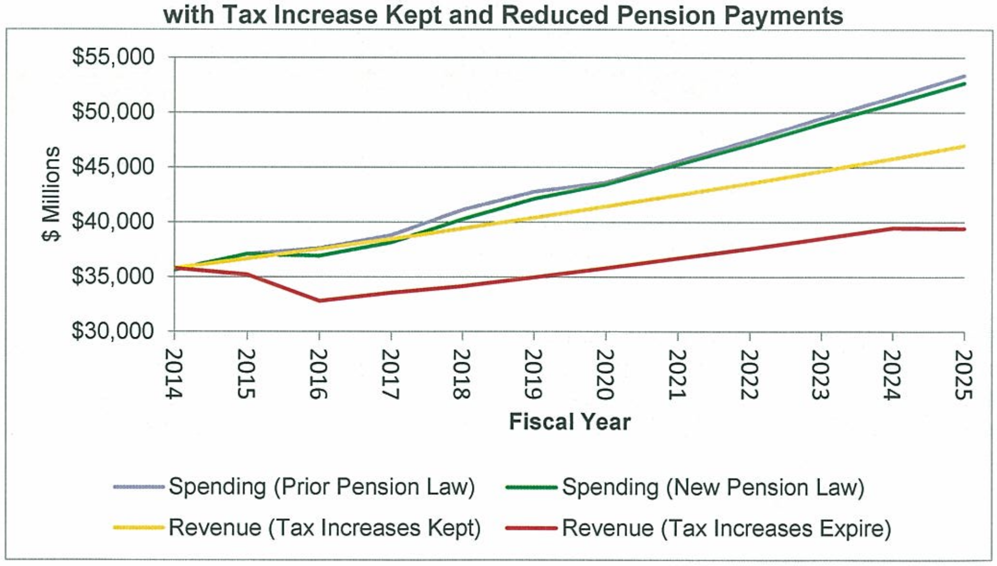


Figure 21 shows that even with after accounting for savings from the reduced pension contributions, and even if the temporary tax rate increases under TABSA are not phased out, the Illinois structural deficit would remain. This means eliminating the structural deficit will require fundamental changes to Illinois state-level tax policy, so that revenue growth can keep pace with service cost growth in the modern economy. It also means state funding for education cannot be increased under current tax law, leaving the state over-reliant on local property taxes to fund education—a situation that is not conducive for small or frankly large businesses. Finally, it means the scheduled phase-out of the temporary tax increases under TABSA is counter-productive and not in the best interests of businesses or the economy.

11. CREATING A FAIR INCOME TAX STRUCTURE WILL BENEFIT SMALL BUSINESS.

Due to its structural deficit, the state does not have the capacity to invest in creating the type of high quality public education system so necessary for economic competitiveness generally and so important to small businesses specifically. That lack of capacity has in turn forced Illinois to over-rely on local property taxes to fund schools. This has driven property taxes up in Illinois, placing a very significant burden on small businesses. As shown in Figure 20, the structural deficit in Illinois will soon worsen significantly, due to the fiscal cliff created by the phase-out of the temporary corporate and individual income tax rate increases scheduled under TABSA over the next two years.

One important reform that could simultaneously take some pressure off of property taxes while enhancing state fiscal capacity to fund schools to desirable levels would be the creation of a fair income tax structure in Illinois. It is textbook tax policy that a "fair" income tax is an income tax that imposes a greater burden on affluent than on middle and low income earners, when tax burden is measured as a percentage of income.[115]

The most direct and efficient way to have a fair income tax is through the utilization of a graduated rate structure, which assesses higher tax rates on higher levels of income and lower tax rates on lower levels of income. This type of fair rate structure allows income tax burden to adjust automatically in accordance with ability to pay. Tracking ability to pay is particularly important to creating tax fairness in the modern economy, given the significant growth in income inequality over the last 30 years as shown in Figure 22.

Figure 22
Change in Average US Income
Accounted For By Income Group

Income Group	1979 — 2011
Top 10%	139.8%
Bottom 90%	-39.8%

Source: Economic Policy Institute's website: http://stateofworkingamerica.org/who-gains/
Data used is from Piketty and Saez, "Income Inequality in the United States, 1913-1998", *Quarterly Journal of Economics*, 118(1), 2003, 1-39 (Tables and Figures Updated to 2011 in Excel format, January 2013), http://elsa.berkeley.edu/~saez/

Far from being fair by tracking ability to pay, Illinois' current tax policy is regressive, assessing much higher overall tax burdens as a percentage of income on low and middle-income families than on affluent families, as shown in Figure 23. Indeed, Illinois has the **second highest** tax burden on low income families in the nation.[116] Implementing a fair income tax reform is one of the best ways to offset at least some of the inherent regressivity of all the other taxes (property, sales and excise) imposed by state and local governments.

Figure 23
Illinois State & Local Taxes Paid as a Share of Family Income For Non-Elderly Taxpayers (Total Tax Burden as a Percentage of Income)

					Top 20%		
Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income	Less than $18,000	$18,000 – $36,000	$36,000 – $57,000	$57,000 – $93,000	$93,000 – $182,000	$182,000–$445,000	$445,000 or more
Average Income in Group	$10,100	$26,900	$46,800	$73,500	$124,100	$273,800	$1,489,200
Sales & Excise Taxes	7.40%	5.80%	4.60%	3.70%	2.70%	1.80%	0.90%
Property Taxes	5.20%	4.20%	4.00%	4.30%	4.50%	3.80%	2.10%
Income Taxes	1.20%	2.20%	2.80%	2.90%	2.90%	2.90%	3.10%
TOTAL TAXES	13.80%	12.10%	11.30%	11.00%	10.10%	8.50%	6.00%
Federal Deduction Offset	–0.0%	–0.1%	–0.5%	–0.7%	–1.2%	–1.0%	–1.1%
TOTAL AFTER OFFSET	13.80%	12.10%	10.90%	10.3.%	9.00%	7.60%	4.90%

Source: Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of Tax Systems in All 50 States* Fourth Edition January 2013), 52. Includes all State and local Sales, Excise, Property, and Income Taxes.

A fair, graduated rate structure would likely not have an adverse impact on small businesses for several reasons. First, as shown in Figure 4, flow-through, individual income taxes only account for 4.9 percent of all taxes and fees paid by businesses. And there is a reason that flow-through tax amount is so low. Most small business owners do not have high incomes from those small businesses. But to realize a meaningful tax increase under a fair, graduated income tax rate structure, a small business owner would have to have a high income from his or her firm. That in turn means, from a tax accounting standpoint, his or her small business would have to be highly profitable. Nationally, however, small business income accounts for less than 4 percent of the income for households with annual earnings in excess of $100,000.[117] In other words, the very high-income households, who would have their higher levels of income taxed at higher rates under a fair income tax, simply do not derive most of their earnings from small businesses. Indeed, out of the small business owners that derive at least one-fourth of their net income from their small business, fully 64.5 percent have federally adjusted gross incomes of $50,000 or less.[118]

A study commissioned by the SBA further confirms that changing to a fair, graduated rate structure will not adversely impact entrepreneurial activity in Illinois. In that study, researchers found that: (i) higher top individual income tax rates in a state had no statistically significant impact on entrepreneurial activity; and (ii) having a graduated individual income tax rate structure did not reduce the share of taxpayers engaged in entrepreneurial activity.[119] Rather, it actually had a small positive impact.[120]

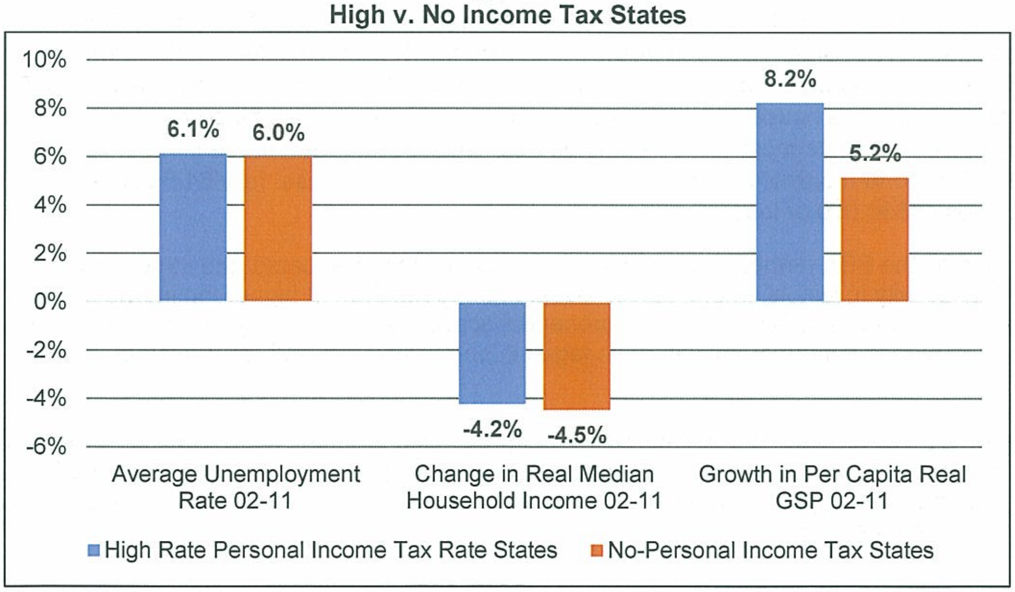
In addition to being unfair to taxpayers, Illinois' regressive tax policy also hurts the state's private sector economic growth in two key ways. First, the structural deficit in part created by regressive tax policy prevents the state from making investments in infrastructure, education, and other priorities that are crucial for small business and essential for Illinois to remain competitive in a global economy.

Second, regressive tax policy directly reduces consumer spending in Illinois. That is a problem, since roughly 68 percent of all economic activity is consumer spending.[121] The best consumers are low and middle income families because they don't earn enough to save. In economic terms, this means they have a high "marginal propensity to consume." That simply means they are much more likely to spend rather than save every additional dollar received. Hence, as low and middle-income families gain more income, they spend it, largely in the local economy.[122] That is why tax relief targeted to low and middle-income families gets spent, which in turn creates jobs.[123] Modestly increasing taxes on the affluent, on the other hand, does not materially reduce their spending, at least according to Nobel Prize winning economist Joseph Stiglitz.[124] That is because affluent families enjoy such a significant portion of all income growth over time that they have a very low marginal propensity to consume. Hence, modest increases in their overall tax liability do not significantly reduce their spending. Yet, contrary to this basic principle, Illinois imposes a significant tax burden on low and middle income families, thereby hurting the economy by reducing the amount of money these families, our best consumers, actually have to spend.

Moreover, the evidence shows that assessing higher marginal state income tax rates on higher income levels does not impede state economic growth over the long-term. Currently, 41 states in America have an income tax, while nine do not.[125] A recent study by the Institute on Taxation and Economic Policy (**ITEP**), reviewed how the nine states with the highest marginal individual income tax rates compared in economic growth to the nine states in America with no individual income tax at all over the last 10 years, from 2002-2011. The ITEP study focused on the following three, core economic indicators: real gross state product growth per capita; real median household income growth; and average annual unemployment rate.[126] The high individual income tax states covered in the study are California, Hawaii, Maine, Maryland, New Jersey, New York, Ohio, Oregon, and Vermont. The states without a broad-based individual income tax are Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming.

As shown in Figure 24, over the period studied, the high individual income tax states realized greater growth in real, per capita gross state product than their non-tax peers (8.2 percent to 5.2 percent), slightly lower loss in real median household income (a decline of -4.2 percent to -4.5 percent) and nearly identical average annual unemployment rates (6.1 percent to 6 percent).[127] These data make it clear that higher marginal income tax rates in and of themselves do not create an economic growth disadvantage. Indeed, the factors that comingle to drive economic growth are far more nuanced than that, and include everything from investments made in education to availability of natural resources, climate, tourism, and quality of infrastructure.

Figure 24
High v. No Income Tax States



Source: Institute on Taxation and Economic Policy, *States with "High Rate" Taxes are Still Outperforming No-Tax States* (Washington, DC: February 2013). Figures 2, 3 & 4

At this juncture in time, Illinois' refusal to change its unfair tax policy that both diminishes consumer spending and forces state budget cuts is particularly problematic. As of December 2013, Illinois still had not come close to replacing the over 346,200 non-farm jobs it lost during the Great Recession.[128] Truth be told, the state never recovered all the jobs it lost during the much milder recession of 2001.[129] Cutting state General Fund spending on core services like education can be expected to harm the private sector's ability to replace those lost jobs for two reasons. In the short term, state spending cuts reduce consumer spending, because the most significant portion of state spending is the wages of the teachers, social workers, health care workers, and correctional officers who provide public services. So when the state cuts spending it is cutting jobs and or wages which has a negative multiplier on the private sector economy.

Indeed, the Center for Economic and Policy Research (**CEPR**) devised a method to determine the potential job losses that could result from addressing a states' budget deficit through spending cuts. The CEPR study showed that every $1 billion in cuts to Illinois' budget could result in over 14,000 lost jobs.[130] Put simply, people have less to spend patronizing local, small businesses which means less demand for the products and services businesses sell, which, of course, leads to job cuts. Over the long term, failure to invest in infrastructure and education have been shown to reduce a state's economic competitiveness—and thereby make it difficult for small and even large businesses to thrive.

The primary reason the state cannot implement a fair tax is simple: the Illinois Constitution prohibits lawmakers from setting marginal rates at different amounts for different levels of income, because it mandates a flat tax rate across all income brackets.[131] Hence, to create a fair rate structure for the individual income tax which has lower rates for lower levels of income and higher rates for higher levels of income, Illinois must amend its constitution. Passing such an amendment will not only create a fairer tax system for people, but also be good for (small) businesses.

ENDNOTES

[1] The National Bureau of Economic Research defines the Great Recession as starting in December 2007 and ending in June 2009.

[2] House Bill 4479.

[3] CTBA analysis of: FY2014 appropriations from CTBA analysis PA 98-34, PA 98-35, PA 98-17, PA 98-33, PA 98-27, PA 98-64, PA 98-50, passed by the 98th General Assembly; hard costs from COGFA, *State of Illinois Budget Summary: Fiscal Year 2014* (Springfield, IL: August 1, 2013), 26; and revenue estimates from COGFA, *Monthly Briefing for the Month Ended: October 2013* (Springfield, IL: October 2013), 9.

[4] United States Census, Statistic of U.S. Businesses, "U.S. & states, totals" (December 2013), http://www.census.gov/econ/susb; Non-employer from United States Census, Nonemployer Statistics, "U.S., States, and Counties (2002-2011)," http://www.census.gov/econ/nonemployer.

[5] United States Census, Statistic of U.S. Businesses, "U.S. & states, totals" (December 2013), http://www.census.gov/econ/susb; Non-employer from United States Census.

[6] Daphne A. Kenyon, Adam H. Langley, and Bethan P. Paquin, *Rethinking Property Tax Incentives for Business* (Cambridge, MA: Lincoln Land Institute of Policy), 29. This study specifically focused on the effect of property tax incentives on business location decisions, but a meta-analysis on all business tax incentives generally was included.

[7] Donald Bruce and John Deskins, *Can State Tax Policies Be Used to Promote Entrepreneurial Activity?* (Springer Publishing: Small Business Economics, 2012); Thomas A. Garrett and Howard J. Wall, *Creating a Policy Environment for Entrepreneurs*, (Washington, DC: Cato Journal, Fall 2006).

[8] Noah Berger and Peter Fisher, *A Well-Educated Workforce is Key to State Prosperity* (Washington, DC: Economic Policy Institute, August 22, 2013), http://www.epi.org/publication/states-education-productivity-growth-foundations/.

[9] Judith Stallman, David Valentine, and Andrew Wesemann, Policy Brief: Public Expenditures and Economic Growth (Columbia, MO: University of Missouri, Institute of Public Policy, Harry S. Truman School of Public Affairs, August 2013).

[10] Andrew Phillips, Robert Cline, Caroline Sallee, Michelle Klassen, and Daniel Sufranski, *Total State and Local Business Taxes: State-by-state estimates for fiscal year 2012* (Washington, DC: Ernst & Young and Council on State Taxation, July 2013), 10; Illinois Department of Revenue, *Annual Report of Collections and Distributions 2012* (Springfield, IL: December 31, 2012).). Ernst & Young's data included both the corporate income tax and PPRT in its corporate income tax category. Ernst & Young's corporate income tax figure is $3.5 billion. CTBA used Illinois Department of Revenue, *Annual Report of Collections and Distributions: Fiscal Years 2011 and 2012* to determine that actual corporate income tax revenue for FY2012 was approximately $2.5 billion, which was calculated by subtracting corporate income tax refunds (shown on page 20 of the cited IDOR report) from the total corporate income tax collection (shown on page 19 of the cited IDOR report). The PPRT revenue was then calculated by subtracting that $2.5 billion from Ernst & Young's reported $3.5 billion.

[11] In general, businesses structure themselves into one of five different legal forms: S-Corporation ("**S-Corp**"), C-Corporation ("**C-Corp**"), partnership, sole proprietorship, and limited liability company (**LLC**). Most small businesses are structured as an S-Corp, partnership, sole proprietorship or LLC. A key distinction between those classifications is that at the federal level, C-Corps pay the corporate income tax, while S-Corps, partnerships, and sole proprietorships pay the individual income tax. Depending how an LLC is structured it pays either the personal or corporate income tax.

[12] Federation of Tax Administrators, *Range of State Corporate Income Tax Rates* (January 1, 2013). http://www.taxadmin.org/fta/rate/corp_inc.pdf.

[13] CTBA analysis of data provided by the Illinois Department of Revenue (May 2013).

[14] Bureau of Economic Analysis; Inflation Adjusted to CPI.

[15] Thomas A. Garrett and Howard J. Wall, *Creating a Policy Environment for Entrepreneurs*, (Washington, DC: Cato Journal, Fall 2006); Michael Mazerov, *Cutting Personal Income Taxes Won't Help Small Businesses Create Jobs and May Harm State Economies* (Washington, DC: Center on Budget and Policy Priorities, February 19,2013), 1; Douglas Elmendorf, Director, Congressional Budget Office, *Policies for Increasing Economic Growth and Employment in 2012, and 2013, Testimony to the Senate Budget Committee,* (Washington, DC: November 15, 2011); Matthew Knittel, Susan Nelson, Jason DeBacker, John Kitchen, James Pearce, and Richard Prisinzano, *Methodology to Identify Small Businesses and Their Owners*, (Office of Tax Analysis, U.S. Department of Treasury: August 2011).

[16] Michael Mazerov, *Cutting Personal Income Taxes Won't Help Small Businesses Create Jobs and May Harm State Economies* (Washington, DC: February 19, 2013), 1.

[17] Michael Mazerov, *Cutting Personal Income Taxes Won't Help Small Businesses Create Jobs and May Harm State Economies* (Washington, DC: February 19, 2013), 7.

[18] For the purposes of this paper, CTBA focuses on creating a healthy General Fund to invest in services such as education. Most infrastructure in the state is funded through various other funds and capital projects which do not come out of the General Fund. However, a healthy General Fund budget is key to an overall healthy state budget.

[19] Michael Mazerov, *Cutting Personal Income Taxes Won't Help Small Businesses Create Jobs and May Harm State Economies* (Washington, DC: February 19, 2013), 14-15.

[20] Noah Berger and Peter Fisher, *A Well-Educated Workforce is Key to State Prosperity* (Washington, DC: Economic Policy Institute, August 22, 2013), http://www.epi.org/publication/states-education-productivity-growth-foundations/.

[21] Michelle T. Bensi, David C. Black, and Michael R. Dowd. "The Education/Growth Relationship: Evidence from Real State Panel Data." *Contemporary Economic Policy* 22, no. 2 (April 22, 2004): 281-298.

[22] Jeffrey Thompson, *Prioritizing Approaches to Economic Development in New England: Skills, Infrastructure, and Tax Incentives* (Amherst, MA: University of Massachusetts Amherst, Political Economy Research Institute, August 18, 2010).

[23] Andrew Phillips, Robert Cline, Caroline Sallee, Michelle Klassen, and Daniel Sufranski, *Total State and Local Business Taxes: State-by-state estimates for fiscal year 2012* (Washington, DC: Ernst & Young and Council on State Taxation, July 2013). Ernst & Young's data included both the corporate income tax and PPRT in its corporate income tax category. Ernst & Young's corporate income tax figure is $3.5 billion. CTBA used Illinois Department of Revenue, *Annual Report of Collections and Distributions: Fiscal Years 2011 and 2012* to determine that actual corporate income tax revenue for FY2012 was approximately $2.5 billion, which was calculated by subtracting corporate income tax refunds (shown on page 20 of the cited IDOR report) from the total corporate income tax collection (shown on page 19 of the cited IDOR report). The PPRT revenue was then calculated by subtracting that $2.5 billion from Ernst & Young's reported $3.5 billion.

[24] Andrew Phillips, Robert Cline, Caroline Sallee, Michelle Klassen, and Daniel Sufranski, *Total State and Local Business Taxes: State-by-state estimates for fiscal year 2012* (Washington, DC: Ernst & Young and Council on State Taxation, July 2013). Ernst & Young's data included both the corporate income tax and PPRT in its corporate income tax category. Ernst & Young's corporate income tax figure is $3.5 billion. CTBA used Illinois Department of Revenue, *Annual Report of Collections and Distributions: Fiscal Years 2011 and 2012* to determine that actual corporate income tax revenue for FY2012 was approximately $2.5 billion, which was calculated by subtracting corporate income tax refunds (shown on page 20 of the cited IDOR report) from the total corporate income tax collection (shown on page 19 of the cited IDOR report). The PPRT revenue was then calculated by subtracting that $2.5 billion from Ernst & Young's reported $3.5 billion.

[25] Illinois State Board of Education, *Fact Sheet: Illinois Ranks Last in State Contribution to P-12 Funding; EFAB "Foundation Level" Not Approved since FY02* (Springfield, IL: February 2013), http://www.isbe.state.il.us/budget/FY14/fact-sheet4-efab.pdf.

[26] All data inflation adjusted to 2011 by CPI; Income Data: US Department of Census Property Tax Data: Illinois Department of Revenue.

[27] All data inflation adjusted to 2011 by CPI; Income Data: US Department of Census Property Tax Data: Illinois Department of Revenue.

[28] All data inflation adjusted to 2011 by CPI; Income Data: US Department of Census Property Tax Data: Illinois Department of Revenue.

[29] United States Census, Statistic of U.S. Businesses, "U.S. & states, totals" (December 2013), http://www.census.gov/econ/susb; Non-employer from United States Census, Nonemployer Statistics, "U.S., States, and Counties (2002-2011)," http://www.census.gov/econ/nonemployer.

[30] U.S. Small Business Administration, Small Business Size Standards, http://www.sba.gov/content/summary-size-standards-industry.

[31] United States Census, Statistic of U.S. Businesses, "U.S. & states, totals" (December 2013), http://www.census.gov/econ/susb; Non-employer from United States Census, Nonemployer Statistics, "U.S., States, and Counties (2002-2011)," http://www.census.gov/econ/nonemployer.

[32] United States Census, Statistic of U.S. Businesses, "U.S. & states, totals" (December 2013), http://www.census.gov/econ/susb.

[33] United States Census, Statistic of U.S. Businesses, "U.S. & states, totals" (December 2013), http://www.census.gov/econ/susb.

[34] SBA Brian Headd, *An Analysis of Small Business and Jobs* (Washington, DC: March 2010), 3.

[35] Small Business Administration. "Frequently Asked Questions – Advocacy: the voice of small business in government." 2012. Cited in William Gale and Samuel Brown, *Small Business, Innovation and Tax Policy* (Tax Policy Center, April 8, 2013) http://www.brookings.edu/research/papers/2013/04/small-business-tax-policy-gale, 12.

[36] William Gale and Samuel Brown, *Small Business, Innovation and Tax Policy* (Tax Policy Center; April 8, 2013) http://www.brookings.edu/research/papers/2013/04/small-business-tax-policy-gale, 12.

[37] William Gale and Samuel Brown, *Small Business, Innovation and Tax Policy* (Tax Policy Center; April 8, 2013) http://www.brookings.edu/research/papers/2013/04/small-business-tax-policy-gale, 12.

[38] Brookings Institute, Testimony of Martin Neil Baily, *The State of American Small Business* (Washington, DC: February 1, 2012), 4.

[39] PA 96-1496.

[40] FY2017 and FY2016 revenue projections compared to FY2014 revenue projection. Source: GOMB, *Three Year Budget Projection: FY2015-FY2017* (Springfield, IL: January 1, 2014).

[41] CTBA analysis of : FY2014 appropriations from CTBA analysis PA 98-34, PA 98-35, PA 98-17, PA 98-33, PA 98-27, PA 98-64, PA 98-50, passed by the 98th General Assembly; hard costs from COGFA, *State of Illinois Budget Summary: Fiscal Year 2014* (Springfield, IL: August 1, 2013), 26; and revenue estimates from COGFA, *Monthly Briefing for the Month Ended: October 2013* (Springfield, IL: October 2013), 9.

[42] Appropriations for FY2014 from CTBA analysis PA 98-34, PA 98-35, PA 98-17, PA 98-33, PA 98-27, PA 98-64, PA 98-50, passed by the 98th General Assembly; and hard costs COGFA, *State of Illinois Budget Summary: Fiscal Year 2014* (Springfield, IL: August 1, 2013), 26. Revenue estimates from COGFA, *Monthly Briefing for the Month Ended: October 2013* (Springfield, IL: October 2013), 9.

[43] FY2009 net appropriations were $29.20 billion, as reported in GOMB, *FY2010 Proposed Operating Budget* (Springfield, IL: March 2009), Ch. 2-12.

[44] Michael Mazerov, *Academic Research Lacks Consensus on the Impact of State Tax Cuts on Economic Growth: A Reply to the Tax Foundation* (Washington, DC: June 17, 2013).

[45] Noah Berger and Peter Fisher, *A Well-Educated Workforce is Key to State Prosperity,* (Washington, DC: Economic Policy Institute, August 22, 2013).

[46] Thomas A. Garrett and Howard J. Wall, *Creating a Policy Environment for Entrepreneurs*, (Washington, DC: Cato Journal, Fall 2006); Michael Mazerov, *Cutting Personal Income Taxes Won't Help Small Businesses Create Jobs and May Harm State Economies* (Washington, DC: Center on Budget and Policy Priorities, February 19, 2013), 1; Douglas Elmendorf, Director, Congressional Budget Office, *Policies for Increasing Economic Growth and Employment in 2012, and 2013, Testimony to the Senate Budget Committee,* (Washington, DC: November 15, 2011); Matthew Knittel, Susan Nelson, Jason DeBacker, John Kitchen, James Pearce, and Richard Prisinzano, *Methodology to Identify Small Businesses and Their Owners*, (Office of Tax Analysis, U.S. Department of Treasury: August 2011); Yasuyuki Motoyama and Brian Danley, *An Analysis of the Geography of Entrepreneurship: Understanding the Geographic Trends of Inc. 500 Companies Over Thirty Years at the State and Metropolitan Levels* (Kansas City, MO: Ewing Marion Kauffman Foundation, September 2012).

[47] Judith Stallman, David Valentine, and Andrew Wesemann, *Policy Brief: Public Expenditures and Economic Growth* (Columbia, MO: University of Missouri, Institute of Public Policy, Harry S. Truman School of Public Affairs, August 2013), 4.

[48] Illinois Department of Commerce and Economic Opportunity, *State Business Incentives: A Comparative Analysis (*Springfield, IL: February 4, 2014*).*

[49] Michael Mazerov, *Cutting Personal Income Taxes Won't Help Small Businesses Create Jobs and May Harm State Economies* (Washington, DC: February 19, 2013), 1.

[50] Daphne A. Kenyon, Adam H. Langley, and Bethan P. Paquin, *Rethinking Property Tax Incentives for Business* (Cambridge, MA: Lincoln Land Institute of Policy), 29. The authors state that location decisions have two broad stages: first choosing a metropolitan area, and then picking a specific regional location. At the first stage, choosing a metropolitan area, they find that property taxes in general are relatively unimportant. Thus, in the specific case of property tax incentives, the authors argue they only impact location decision when a business is deciding on a specific regional location, and only when all other factors (like proximity to market and skill of workforce) are equal.

[51] Michael Mazerov, *Cutting Personal Income Taxes Won't Help Small Businesses Create Jobs and May Harm State Economies* (Washington, DC: February 19, 2013), 14-15.

[52] Rhett Morris, *What Do the Best Entrepreneurs Want in a City? Lessons from the Founders of America's Fastest-Growing Companies* (Endeavor, February 2014).

[53] Rhett Morris, *What Do the Best Entrepreneurs Want in a City? Lessons from the Founders of America's Fastest-Growing Companies* (Endeavor, February 2014).

[54] Veronique de Rugy, *Infrastructure Spending Increase in the Last 10 Years* (Arlington, VA: George Mason University, George Mason University, September 12, 2011), http://mercatus.org/publication/infrastructure-spending-increase-last-10-years.

[55] Francisco Rodriguez, *Have Collapses in Infrastructure Spending led to Cross-Country Divergence in Per Capita GDP?* (Middletown, CT: Wesleyan University, Department of Economic and Social Affairs, Working Paper No. 52, July 2007), 2.

[56]Judith Stallman, David Valentine, and Andrew Wesemann, *Policy Brief: Public Expenditures and Economic Growth* (Columbia, MO: University of Missouri, Institute of Public Policy, Harry S. Truman School of Public Affairs, August 2013), 4.

[57] Lori Montgomery, "Siemens plant in Charlotte offers lessons as Obama, Romney Talk Job Creation," *Washington Post,* September 4, 2012, http://www.washingtonpost.com/business/economy/siemens-plant-in-charlotte-offers-lessons-as-obama-romney-talk-job-creation/2012/09/04/f52304fa-f30c-11e1-adc6-87dfa8eff430_story.html.

[58] GOMB, *Illinois' Economic and Fiscal Policy Report* (Springfield, IL: January 1, 2014), http://www2.illinois.gov/gov/budget/Documents/Economic%20and%20Fiscal%20Policy%20Reports/FY2014/Economic%20and%20Fiscal%20Policy%20Report%201-1-2014.pdf.

[59] Ernst & Young's data included both the corporate income tax and PPRT in its corporate income tax category. Ernst & Young's corporate income tax figure is $3.5 billion. CTBA used Illinois Department of Revenue, *Annual Report of Collections and Distributions: Fiscal Years 2011 and 2012* to determine that actual corporate income tax revenue for FY2012 was approximately $2.5 billion, which was calculated by subtracting corporate income tax refunds (shown on page 20 of the cited IDOR report) from the total corporate income tax collection (shown on page 19 of the cited IDOR report). The PPRT revenue was then calculated by subtracting that $2.5 billion from Ernst & Young's reported $3.5 billion.

[60] CTBA estimate of property tax extensions by property type using: Illinois Department of Revenue, *Property Tax Statistics, Table 8: Average Tax Rates, 2007- 2011 and Table 15: Comparison of Equalized Assessed Valuations by Class of Property.* http://www.revenue.state.il.us/AboutIdor/TaxStats/PropertyTaxStats/2011/index.htm. This is based on the property classified as commercial (22.2 percent) and industrial (8.5 percent). The remaining 3 percent of property taxes are for properties classified as farm, railroad, and mineral.

[61] IRSI Issue Brief: *HJRCA 49: A Constitutional Amendment Regarding The Rules Governing Pension Benefit Increases* (Chicago, IL: June 2012), 4.

[62] Federal Tax Administrators. "2011 State & Local Revenue as a percentage of personal income." http://www.taxadmin.org/fta/rate/11stl_pi.html

[63] Joyce Errecart, Ed Gerrish, Scott Drenkard, *States Moving Away from Taxes on Tangible Personal Property* (Washington DC: Tax Foundation, October 4, 2012).

[64] 30 ILCS 115/12. In addition, public utilities pay a specific replacement tax in an amount equal to 0.8 percent tax on invested capital. Other replacement taxes include the Electricity Distribution Tax and Telecommunications Infrastructure Maintenance Fee.

[65] Illinois Department of Revenue*, Analysis of Selected Illinois Business Tax Incentives* (Springfield, IL; April 2009) 5.

[66] Forty-four states impose a state corporate income tax. Texas, Nevada, Ohio, South Dakota, Washington and Wyoming do not impose a state corporate income tax. For purposes of this figure CTBA is comparing Illinois' corporate income tax rate with states that impose a similar corporate income tax.

[67] Communication with the Illinois Department of Revenue in May 2013.

[68] Communication with the Illinois Department of Revenue in May 2013.

[69] PA 96-1496 35 ILCS 5/201 (b)(11).

[70] JD Michael LLC, *Probing Beneath the Surface: Understanding Why So Many Corporations Do Not Pay Illinois Corporate Income Tax* (Chicago: Illinois Chamber of Commerce and the Taxpayers' Federation of Illinois, February 2014).

[71] U.S. Census Bureau, State Government Tax Collections, (Washington, DC: March 2011) http://www.census.gov/govs/statetax/historical_data_2010.html.

[72] In the 2010 Annual Survey of State Annual Tax Collections, Illinois' reported corporate income tax collection included both the corporate income tax collections and the PPRT collections. Therefore, CTBA adjusted the Census Bureau reported number to exclude PPRT collections. Data is not available at this time to determine whether PPRT collections were included in prior year surveys. Illinois net corporate income tax revenue used for the 2010 adjustment is $1.36 billion from COGFA, *State of Illinois Budget Summary: Fiscal Year 2014* (Springfield, IL: August 1, 2013), 50.

[73] OECD, *Tax Revenues Continue to Rise Across the OECD* (December 17, 2013), http://www.oecd.org/newsroom/tax-revenues-continue-to-rise-across-the-oecd.htm.

[74] U.S. Department of Labor, Bureau of Labor Statistics, All total nonfarm U.S. employees from June 2009 – December 1, 2013.

[75] U.S. Department of Labor, Bureau of Labor Statistics, All total nonfarm U.S. employees from December 2007 – June 2009.

[76] Nin-Hai Tseng "We're Still 8.3 million jobs from full recovery," *CNN Money*, September 16, 2013.

[77] Douglas Elmendorf, Director, Congressional Budget Office, "Policies for Increasing Economic Growth and Employment in 2012, and 2013," Testimony to the Senate Budget Committee, November 15, 2011; This CBO report illustrates that reducing taxes on business

income would only have a very small effect on employment and any short term growth from such policies may be offset in the long term.

[78] Thomas A. Garrett and Howard J. Wall, *Creating a Policy Environment for Entrepreneurs*, (Washington, DC: Cato Journal, Fall 2006); Michael Mazerov, *Cutting Personal Income Taxes Won't Help Small Businesses Create Jobs and May Harm State Economies* (Washington, DC: Center on Budget and Policy Priorities, February 19, 2013), 1; Douglas Elmendorf, Director, Congressional Budget Office, *Policies for Increasing Economic Growth and Employment in 2012, and 2013, Testimony to the Senate Budget Committee,* (Washington, DC: November 15, 2011); Matthew Knittel, Susan Nelson, Jason DeBacker, John Kitchen, James Pearce, and Richard Prisinzano, *Methodology to Identify Small Businesses and Their Owners*, (Office of Tax Analysis, U.S. Department of Treasury: August 2011); Yasuyuki Motoyama and Brian Danley, *An Analysis of the Geography of Entrepreneurship: Understanding the Geographic Trends of Inc. 500 Companies Over Thirty Years at the State and Metropolitan Levels* (Kansas City, MO: Ewing Marion Kauffman Foundation, September 2012).

[79] Yasuyuki Motoyama and Brian Danley, *An Analysis of the Geography of Entrepreneurship: Understanding the Geographic Trends of Inc. 500 Companies Over Thirty Years at the State and Metropolitan Levels* (Kansas City, MO: Ewing Marion Kauffman Foundation, September 2012); Thomas A. Garrett and Howard J. Wall, *Creating a Policy Environment for Entrepreneurs*, (Washington, DC: Cato Journal, Fall 2006); Michael Mazerov, *Cutting Personal Income Taxes Won't Help Small Businesses Create Jobs and May Harm State Economies* (Washington, DC: Center on Budget and Policy Priorities, February 19, 2013), 1; William Gale and Samuel Brown, *Small Business, Innovation and Tax Policy* (Washington, DC: Tax policy Center; April 8, 2013).

[80] William McBride, *What is the Evidence on Taxes and Growth? Tax Foundation Special Report No. 207*, (Washington, DC: December 18, 2012).

[81] Michael Mazerov, "Academic Research Lacks Consensus on the Impact of State Tax Cuts on Economic Growth: A Reply to the Tax Foundation" (Washington, DC: June 17, 2013), 2.

[82] Michael Mazerov, "Academic Research Lacks Consensus on the Impact of State Tax Cuts on Economic Growth: A Reply to the Tax Foundation" (Washington, DC: June 17, 2013), 2.

[83] Federal Tax Administrators. "2011 State & Local Revenue as a percentage of personal income." http://www.taxadmin.org/fta/rate/11stl_pi.html.

[84] CTBA calculation using Federal Tax Administrators. "2011 State & Local Tax Collection by Source." "Microsoft Excel." http://www.taxadmin.org/fta/rate/burden.html.

[85] Totals for Illinois do not add due to rounding.

[86] Ernst & Young's data included both the corporate income tax and PPRT in its corporate income tax category. Ernst & Young's corporate income tax figure is $3.5 billion. CTBA used Illinois Department of Revenue, *Annual Report of Collections and Distributions: Fiscal Years 2011 and 2012* to determine that actual corporate income tax revenue for FY2012 was approximately $2.5 billion, which was calculated by subtracting corporate income tax refunds (shown on page 20 of the cited IDOR report) from the total corporate income tax collection (shown on page 19 of the cited IDOR report). The PPRT revenue was then calculated by subtracting that $2.5 billion from Ernst & Young's reported $3.5 billion.

[87] Totals for Illinois do not add due to rounding.

[88] Illinois State Board of Education, *FY2014 Operating Budget, Public Acts 98-033 & 98-034* (Springfield, IL: June 27, 2013), http://www.isbe.state.il.us/budget/FY14/fy14-budget.pdf; Illinois State Board of Education, *FY10 General Funds Allocation As Approved by the State Board of Education on July 21, 2009* (Springfield, IL: July 21, 2009), http://www.isbe.state.il.us/board/meetings/2009/july/fy10_board_adopted_budget.pdf.

[89] Mark Dixon, U.S. Census Bureau, "Public Education Finances: 2011", G11-ASPEF, U.S. Government Printing Office, (Washington, DC: May, 2013), 28. http://www2.census.gov/govs/school/11f33pub.pdf.

[90] CTBA subtracted the state's contribution for amortizing unfunded pension liabilities ("amortization contribution") from the state share of spending in the U.S. Department of Education, National Center for Education Statistics report. In FY2011, the ISBE budget was $6.953 billion, which is lower than the figure in the U.S. Department of Education, National Center for Education Statistics report of $9.305 billion. CTBA determined that the U.S. Department of Education, National Center for Education Statistics report also included pension costs in FY2011: both the normal cost and amortization contribution. CTBA included the normal pension cost of $849 million in total state spending, but subtracted the amortization contribution of $1,638.9 million from the U.S. Department of Education, National Center for Education Statistics report's state spending figure. Thus. the state spending on education figure (or the numerator) becomes $7.666 billion. CTBA then also subtracted the amortization contribution from the total education spending, bringing that figure (or the denominator) from $28.7 billion to $27.06 billion.

[91] See previous endnote.

[92] Noah Berger and Peter Fisher, *A Well-Educated Workforce is Key to State Prosperity* (Washington, DC: Economic Policy Institute, August 22, 2013), http://www.epi.org/publication/states-education-productivity-growth-foundations/.

[93] Jeffrey Thompson, *Prioritizing Approaches to Economic Development in New England: Skills, Infrastructure, and Tax Incentives* (Amherst, MA: University of Massachusetts Amherst, Political Economy Research Institute, August 18, 2010).

[94] Bureau of Labor Statistics, Current Population Survey, (Washington, D.C.: May 22, 2013) http://www.bls.gov/emp/ep_chart_001.htm.

[95] Noah Berger and Peter Fisher, *A Well-Educated Workforce is Key to State Prosperity* (Washington, DC: Economic Policy Institute, August 22, 2013), 1-2; Michelle T. Bensi, David C. Black, and Michael R. Dowd. "The Education/Growth Relationship: Evidence from Real State Panel Data." *Contemporary Economic Policy* 22, no. 2 (April 22, 2004): 297.

[96] Michelle T. Bensi, David C. Black, and Michael R. Dowd. "The Education/Growth Relationship: Evidence from Real State Panel Data." *Contemporary Economic Policy* 22, no. 2 (April 22, 2004): 297.

[97] CTBA analysis using (i) US Census Bureau. "Annual Estimates of the Resident Population: April 1, 2010 to July 1, 2012: July 2012 totals." Last updated December 2012. http://factfinder2.census.gov/faces/nav/jsf/pages/index.xhtml; and (ii) US Bureau of Economic Analysis. "2012 State GDP." Last modified June 6, 2011. http://www.bea.gov/.

[98] S.Q. Cornman, P. Keaton, and M. Glander, "Revenues and Expenditures for Public Elementary and Secondary School Districts: School Year 2010–11 (Fiscal Year 2011)" National Center for Education Statistics, U.S. Department of Education, (Washington, DC: September, 2013), 8. http://nces.ed.gov/pubs2013/2013344.pdf. Additionally, similarly to endnote 90, CTBA calculated the percentage of the state's contribution for amortizing unfunded pension liabilities ("amortization contribution") from the total figure of education spending in Illinois ($1,638.9/$27,061.5 = 6.056%) in the U.S. Department of Education, National Center for Education Statistics report. CTBA included the normal pension cost in total state spending. Then CTBA 'pro-rated' the 'Current expenditures per Pupil' median figure of Illinois by 93.944% (1 - .06056). This new figure, a new approximation of the state's median 'Current expenditure per Pupil', is $9,459.

[99] Illinois State Board of Education, *FY2014 Operating Budget, Public Acts 98-033 & 98-034* (Springfield, IL: June, 27, 2013), http://www.isbe.net/budget/FY14/fy14-budget.pdf.

[100] Education Funding Advisory Board, *Illinois Education Funding Recommendations* (Springfield, IL: January 2013), 1.

[101] State of Illinois Comptroller, GAAP Fund Balance, http://www.ioc.state.il.us/index.cfm/fiscal-condition/gaap-fund-balance.

[102] COGFA, *State of Illinois Budget Summary: Fiscal Year 2014* (Springfield, IL: August 1, 2013), 26.

[103] Sources: FY2000 unadjusted appropriations from Governor's final budget summary for FY2000; and FY2014 CTBA analysis PA 98-34, PA 98-35, PA 98-17, PA 98-33, PA 98-27, PA 98-64, PA 98-50, passed by the 98th General Assembly. Inflation for healthcare inflated by Midwest Medical Care CPI; all other appropriations adjusted using ECI-C and Midwest CPI from the BLS as of January 2014, and population growth from the Census Bureau as of January 2014.

[104] FY2009 net appropriations were $29.20 billion, as reported in GOMB, *FY2010 Proposed Operating Budget* (Springfield, IL: March 2009), Ch. 2-12.

[105] CTBA analysis using: (i) US Census Bureau. "Annual Estimates of the Resident Population: April 1, 2010 to July 1, 2012: July 2012 totals." Last updated December 2012. http://factfinder2.census.gov/faces/nav/jsf/pages/index.xhtml; and (ii) US Bureau of Economic Analysis. "2012 State GDP." Last modified June 6, 2011. http://www.bea.gov/.

[106] CTBA analysis using: (i) US Census Bureau. "Annual Estimates of the Resident Population: April 1, 2010 to July 1, 2012: July 2012 totals." last updated December 2012. http://factfinder2.census.gov/faces/nav/jsf/pages/index.xhtml; (ii) National Association of State Budget Officers, Fall 2012: Fiscal Survey of the States (2012), 4. (iii)General Fund budgets from all 50 states.

[107] CTBA analysis using: (i) National Association of State Budget Officers, Fall 2012: Fiscal Survey of the State (2012), 4. (ii)General Fund budgets from all 50 states. (iii) US Bureau of Economic Analysis. "2012 State GDP." Last modified June 6, 2013. http://www.bea.gov/.

[108] US Census Bureau. "2011 State Government: Total Full-Time Equivalent State Employees." Accessed July 10, 2013. http://www.census.gov/govs/apes/.

[109] The structural deficit model shown in Figure 15 was created before the recent pension legislation (Public Act 98-599) was signed into law. PA 98-599 reduces the state's future contributions to the state retirement systems by reducing benefits for current employees and retirees. However, that legislation will be litigated and may be found unconstitutional because of Illinois' state constitutional protection of public pension benefits.

[110] GOMB, *2014 Three Year Projection* (Springfield, IL: January 1, 2014).

[111] COGFA, *Monthly Briefing for the Month Ended: October 2013* (Springfield, IL: October 2013).

[112] GOMB, *2014 Three Year Projection* (Springfield, IL: January 1, 2014).

[113] Spending assumptions for FY2018-FY2025: (i) projecting spending on core services using the Congressional Budget Office's 2013 projections on wage growth, and population growth using the Illinois Department of Commerce and Economic Opportunity's population projections; (ii) pension contributions based on the funding plan put in place by Public Act 88-593; (iii) statutory transfers are projected based on historic Midwest CPI-U growth and population growth using the Illinois Department of Commerce and Economic Opportunity's population projections; and (iv) bond debt service is the General Revenue Fund schedule reported by the Comptroller in FY2012 Bond Indebtedness and Long Term Obligations. Revenue estimates beyond FY2017 assume (i) state source growth will be in-line with historic rate of 2.8 percent and (ii) federal funding will be flat.

[114] New pension contributions for FY2016-FY2017 from GOMB, *2014 Three Year Projection* (Springfield, IL: January 1, 2014); projections for future years estimated using contributions from State of Illinois, *Investor Presentation: $1,000,000,000 State of Illinois General Obligation Bonds Series, February 2014* (Springfield, IL: January 24, 2014) and contributions for the Judges Retirement System from COGFA, *Special Pension Briefing* (Springfield, IL: November 2013), 8.

[115] Hugh Stretton, *Economics: a New Introduction* (London: Pluto Press, 1999), 623.

[116] Institute on Taxation and Economic Policy, *Who Pays? A Distribution Analysis of the Tax Systems in All 50 States, Fourth Edition* (Washington, DC: January 2013), 35. The only state with a higher state and local tax burden on the lowest 20% of families is Washington, which does not have a state personal income tax.

[117] Michael Mazerov, *Cutting Personal Income Taxes Won't Help Small Businesses Create Jobs and May Harm State Economies* (Washington, DC: February 19, 2013).

[118] Matthew Knittel, Susan Nelson, Jason DeBacker, John Kitchen, James Pearce, and Richard Prisinzano, *Methodology to Identify Small Businesses and Their Owners* (Washington, DC: Office of Tax Analysis, U.S. Department of Treasury, August 2011), 36.

[119] Donald Bruce and John Deskins, "*Can tax policies be used to promote entrepreneurial activity?*" (Washington, DC; February 2010).

[120] Donald Bruce and John Deskins, "*Can tax policies be used to promote entrepreneurial activity?*" (Washington, DC; February 2010).

[121] CTBA analysis of U.S. Bureau of Economic Analysis, *National Income and Product Accounts Tables.* Washington: Bureau of Economic Analysis, December 20, 2013. (Table 1.1.5. Gross Domestic Product).

[122] John Springer and Heidi Goldberg, *Relieving the Recession: Nineteen Ways States can Assist Low-Income Families During the Downturn* (Washington, DC: Center on Budget and Policy Priorities, February 2, 2002).

[123] J. Bradford DeLong, *The Size of the Multiplier and the Marginal Propensity to Consume* (UC Berkeley, Department of Economics: March 1998).

[124]Joseph Stiglitz – "Letter to Governor David A. Paterson," March 2008, Columbia University Business School.

[125] Federation of Tax Administrators, *State Individual Income Taxes* (Washington, DC: January 1, 2013) http://www.taxadmin.org/fta/rate/ind_inc.pdf.

[126] Institute on Taxation and Economic Policy, *States with "High Rate" Taxes are Still Outperforming No-Tax States* (Washington, DC: February 2013).

[127] Institute on Taxation and Economic Policy, *States with "High Rate" Taxes are Still Outperforming No-Tax States* (Washington, DC: February 2013).

[128] United States Bureau of Labor Statistics, Local Area Unemployment Statistics: Illinois employment data, seasonally adjusted, 2000-2013. Data retrieved October 2, 2013.

[129]United States Bureau of Labor Statistics. State and Area Employment Division. Illinois employment data, seasonally adjusted, 2000-2010. Data retrieved 10-26-2010.

[130] Matt Sherman, *More Budget Belt-Tightening Means More Job Losses for States* (Washington, DC: Center for Economic and Policy Research, September 2009).

[131]Illinois Constitution Article IX, Section 3(a).