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Sensibly Reforming the Tax Structure and Tax Incentive Policies of Illinois

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and the State Government Administration Committee
of the Illinois House of Representatives

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Thank you for the opportunity to offer this written submission, with the attached documents. For those unfamiliar, the Tax Foundation is an independent tax policy research organization based in Washington, DC. Since 1937, our principled research, insightful analysis, and engaged experts have informed smarter tax policy at all levels of government. Information on our funding is at www.taxfoundation.org/funding.

Our Center for State Tax Policy analyzes state tax trends from a national perspective, and provides tools to compare state tax systems with each other. One of these tools is our annual *State Business Tax Climate Index*. The *Index* compares state tax structures on over 100 different variables important to business climate, job creation, and economic growth in the areas of individual income tax, corporate income tax, sales tax, property taxes, and unemployment insurance taxes.

If you were to get all of the nation's state tax experts in one room and ask them what good policy is, the answer you'd get from 9 out of 10 of them is four words: Broad Bases, Low Rates. In many ways, Illinois does precisely the opposite. The state sales tax is one of the narrowest in the country—exempting many goods and services—but the rate is among the highest. Property taxes are high. And the corporate income tax rate is among the highest in the world. Faced with this uncompetitive rate, companies take and seek the incentives to reduce their tax costs.

There are three types of tax incentives: (1) those required by the inherent structure of the tax system to prevent double-taxation, like the credit for taxes paid to another state; (2) social policy tax provisions, like child tax credits or the EITC, and (3) incentives to encourage certain business activity, like R&D credits or targeted incentive packages.

The Pew Center on the States looked at tax incentive programs in thirteen states and came up with four overarching recommendations: (1) Set the goal for each incentive, ensure it matches state goals; (2) measure whether an incentive meets these goals, such as by looking at the economic impact of incentives with data and analysis; (3) build evaluation of incentives into the budget process, so they are weighed against other policy priorities; and (4) do this evaluation regularly and comprehensively.

That's all important. I'd also add that providing certainty to taxpayers is important, as the specter of future increases can have a deterring effect on business activity. But if you want to tackle the root cause of corporate tax incentives, do something about the rate. If Illinois were to reduce its uncompetitive 9.5 percent corporate tax rate to something reasonable, it would reduce the pressure for targeted tax incentives. Short of that, it'll be like squeezing sand—the harder you apply pressure, the more will slip through your fingers. Trying to scare companies from taking credits by threatening to release confidential individual tax returns won't achieve anything other than counterproductively worsening Illinois's business climate.

Just to highlight the importance of a good tax system overall rather than targeted credits, consider this. Exactly how many jobs are created by the EDGE credit is of some dispute, but I read in one statement by the governor in 2011 that it would be about 5,700 jobs over ten years. Let's say all those investments pan out and all those jobs are created, with that number at about 570 per year. Illinois high schools graduate over 120,000 students a year. Even a successful EDGE credit times one hundred wouldn't soak up half that need. A broad based low rate tax system, with competitive tax rates for the state's small, medium, and large businesses, is essential.

As I indicated I would at the January 17 hearing, I have included five attached documents: (1) our 2013 *Facts & Figures* booklet – the 2014 booklet will be released later this month and I will provide copies when they are available; (2) our *State Business Tax Climate Index*; (3) our *Location Matters* book; (4) a review of academic evidence on the relationship of taxes and economic growth; and (5) the study by the Pew Center on the States on good practices for tax incentives.

As always, we're happy to be a resource. Illinois faces many challenges but is well-positioned geographically and economically if the state can get its fiscal house in order. I want to see that happen, and I know you do too.